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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1458

MORGAN GUARANTY TRUST COMPANY OF NEW YORK,

Petitioner,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt; ANSWERING EMPLOYEES OF BANKRUPT; LOCAL 807-IBT; RETAIL CLERKS INTERNATIONAL ASSOCIATION; and NATIONAL LABOR RELATIONS BOARD,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Petitioner Morgan Guaranty Trust Company of New York ("Morgan Guaranty") prays that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Second Circuit, affirming an order of the United States District Court for the Southern District of New York, which in turn affirmed an order of the Bankruptcy Court for the Southern District of New York. The Second Circuit's judgment continues and extends a rule of bankruptcy administration that has been rejected by each of the two other Circuits which have considered the issue.

The Second Circuit held with respect to thousands of employees terminated during the brief Chapter XI phase of the W. T. Grant Company's total liquidation bankruptcy—the largest corporate liquidation in the history of the

United States—that the full amount of their severance pay, even though earned over many years' employment, was required to be classified in its entirety as a first priority expense of administration rather than be allocated over the term of employment. As a result, such severance pay stands to be paid in full, to the direct prejudice of general creditors of the Grant bankrupt estate, in particular a group of Grant's lending banks led by Morgan Guaranty. The Second Circuit's holding is in flat contradiction of the principle of equal distribution of assets among creditors of a bankrupt, and it is in acknowledged conflict with holdings of the First and Third Circuits.

Because the conflict among the Circuits bears directly on the balancing of priority claims against the claims of general creditors, the conflict is one which has been and will continue to be material in each of the some 4,000 corporate insolvency proceedings filed each year in the Federal courts. The new Bankruptcy Code works no change that resolves the conflict, so that the issue promises to remain.

Until resolved, this point of bankruptcy law will hinder already protracted bankruptcy proceedings and will necessitate further appellate review in other Circuits. Resolution of the issue now by this Court will be of evident benefit to the administration of bankruptcy courts and the prompt handling of corporate insolvency proceedings.

Opinions Below

The opinion and judgment of the Second Circuit was filed January 3, 1980 and has not yet been reported. It is set forth in Appendix I. The decision and order of the District Court dated July 18, 1979, which was affirmed by the Second Circuit, is reported at 474 F. Supp. 788 (S.D. N.Y. 1979) and is set forth in Appendix II. The decision and order of the Bankruptcy Court dated June 22, 1978, which was affirmed by the District Court, is set forth in Appendix III.

Jurisdiction

The judgment of the Court of Appeals was entered on January 3, 1980. No petition for rehearing was filed. The jurisdiction of this Court is based upon 28 U.S.C. § 1254(1) and Section 24c of the Bankruptcy Act, 11 U.S.C. § 47c.

Statutes Involved

The relevant portion of the Bankruptcy Act, ch. 541, § 64a, 30 Stat. 563 (1898) (as amended), which governs this case, provides:

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the costs and expenses of administration, including the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; . . . (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding. . . ."

The parallel provisions contained in the new Bankruptcy Code are, *first,* Sections 507(a)(1) and (3), 11 U.S.C. §§ 507(a)(1) and (3) (1979), which provide:

> "(a) The following expenses and claims have priority in the following order:
>
> (1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28. . . .
>
> • • •
>
> (3) Third, allowed unsecured claims for wages, salaries, or commissions, including vacation, severance and sick leave pay—
>
> (A) earned by an individual within 90 days before the date of the filing of the petition or the

> date of the cessation of the debtor's business, whichever occurs first; but only
>
> (B) to the extent of $2,000 for each such individual . . .;"

and, *second,* Section 503(b) of the Bankruptcy Code, 11 U.S.C. § 503(b) (1979), which provides in part that:

> "(b) After notice and a hearing, there shall be allowed, administrative expenses, other than claims allowed under section 502(f) of this title, including—
>
> (1)(A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case; . . ."

Question Presented

Is severance pay, earned in respect of many years' employment and dependent in amount on the length of that employment, payable in full as a first priority expense of administration because the termination of employment occurs during the Chapter XI portion of a liquidation bankruptcy?*

Statement of the Case

On October 2, 1975 W. T. Grant Company filed a petition for an arrangement under Chapter XI of the Bankruptcy

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* This case also raises an important question of bankruptcy procedure regarding the standards for the assumption of executory contracts by troubled debtors, as to which the decision below conflicts with a recent decision of the Ninth Circuit, *In re Hotel Circle, Inc.,* docket no. 76-3066 (9th Cir. Jan. 21, 1980), set forth in Appendix IV. We do not address that question in this brief, but respectfully adopt the argument in the companion petition of the Grant Trustee which primarily addresses that issue.

Act.* Grant had operated a chain of over 1,000 retail outlets for the sale of general lines of merchandise. To try to save a nucleus of the company's stores, 715 outlets were promptly liquidated and closed during the first three months of the Chapter XI case, and over 35,000 employees were let go. The effort to salvage the remainder of the company failed, and the rest of the stores were ordered liquidated on February 12, 1976. The remaining employees were discharged during the next two months, and Grant was adjudged a bankrupt on April 13, 1976.

Prior to its Chapter XI petition, Grant had offered its employees a wage and compensation package which included severance pay benefits dependent on each employee's period of employment. As the employment period increased, the amount of severance pay benefits for involuntary termination also increased. Not all of Grant's employees were covered by identical severance pay provisions, but the basic provisions were uniform for all employees. The company's basic severance pay provisions typically provided:

Length of Service	Termination Amount
Up to 6 mos.	No pay but reasonable notice
6 mos.-11 mos.	10% of week's salary for each month over 6 mos.
1-3 yrs.	1 week's pay
3-5 yrs.	2 weeks' pay
5-7 yrs.	3 weeks' pay
7-10 yrs.	4 weeks' pay
Over 10 yrs.	Specially calculated by management

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* The Bankruptcy Act, ch. 541, 30 Stat. 544 (1898) (as amended), will be referred to herein as the "Act". The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. §§ 1 to 151326 (1979)), will be referred to herein as the "Code".

Severance pay was never paid by Grant as debtor-in-possession to its employees discharged during the Chapter XI store closings and liquidation. On April 8, 1976, in the final days of the Chapter XI case, after all stores had been closed and when it was known that the company would be adjudged a bankrupt on April 13, Grant for the first time obtained an order fixing April 27, 1976 as a hearing date to consider an application for authority to make severance payments to discharged employees. That application lapsed following Grant's adjudication as a bankrupt and was not adopted by the Trustee of the Grant estate.

Instead, after receipt and analysis of 41,000 employee claims for severance pay benefits totalling in excess of $20,000,000,* the Trustee made his own application to the Bankruptcy Court on May 10, 1977 for instructions as to their treatment. Since Grant's wage and compensation package had provided that the amount of severance pay was based on the duration of each employee's employment, the Trustee proposed that: (a) the portion of a discharged employee's severance pay claim relating to his employment between the commencement of the Chapter XI case and the date of his discharge be paid in full as a cost and expense of administration under Section 64a(1) of the Act; (b) the portion of the claim relating to his employment during the three months prior to the commencement of the Chapter XI case be paid under the second priority contained in Section 64a(2) of the Act (not in excess of $600 per claimant); and (c) the balance of the claim be treated as a pre-Chapter XI non-priority unsecured claim. The Trustee further proposed that each employee's total severance pay be allocated over a common 12-month period in order to be more generous to employees.

Morgan Guaranty, acting as agent for twenty-six banks constituting Grant's principal lenders, endorsed this allo-

* Some 28,000 valid claims totalling approximately $11,382,000 were left after elimination of duplications.

cation and objected to any plan in excess of the Trustee's proposal.* Objections to the proposal were interposed by the respondents, who claimed that all severance pay should be paid 100% as an administration expense. After a hearing, the Bankruptcy Court noted in its opinion that two Circuits adhered to the allocation of severance pay in a manner similar to the Trustee's proposal, citing *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976), and *In re Public Ledger, Inc.*, 161 F.2d 762 (3rd Cir. 1947). While the Bankruptcy Court found allocation to be "appealing", Appendix III at 28a, it concluded that it was "bound" by the decision of the Second Circuit in *Straus-Duparquet, Inc.* v. *Local No. 3, IBEW*, 386 F.2d 649 (2d Cir. 1967), quoting that decision as follows:

> " '[s]everance pay is not earned from day to day and does not 'accrue' so that a proportionate part is payable under any circumstances. After the period of eligibility is served, the full severance pay is due whenever termination of employment occurs.' 386 F.2d at 651." Appendix III at 28a.

The District Court, whose jurisdiction was invoked under 28 U.S.C. §§ 1334 and 1331, affirmed, agreeing that it, too, was bound by the Second Circuit's rule of *Straus-Duparquet*. Appendix II at 13a-14a.

The Second Circuit affirmed in a short opinion acknowledging that other Circuits differed from "the law of this Circuit" and holding that "we reaffirm and adhere to our decision in *Straus-Duparquet* . . . and hold that the entire portion of the employees' severance pay claims is entitled

* The ultimate recovery of the bank group and of general unsecured creditors is estimated in the range of 50%. The Trustee's allocation formula for severance pay would result in an average payment of over 80% per severance pay claim, because both the administration and the second priority portions would receive 100% payment, while only the general unsecured portion would received the 50% payment. The Trustee thus sought to save some $2 million for Grant's general estate by his severance pay proposal.

to first priority as costs and expenses of administration." Appendix I at 6a.

REASONS FOR GRANTING THE WRIT

The Court of Appeals' decision is judicial legislation at variance with a set and express statutory scheme. It makes an anomaly of severance pay claims by giving them the pre-eminent status accorded to necessary expenses of actual bankruptcy administration. Notwithstanding the Act's and the new Code's express relegation of a portion of wages to a lower priority and of the remainder to unsecured status, the decision permits what are in reality prepetition obligations of the debtor to leap-frog to the highest priority of claims. This confuses the statutory scheme of the Act and contradicts the fundamental concept of bankruptcy, equality of asset distribution.

The Court of Appeals' decision will continue this confusion under the new Code, since the rationale of the decision turns on a classification—"administration expenses"—which is found in the new Code as well as in the old Act. For the same reason, the decision affects both reorganizations and liquidations, both of which incorporate the concept of administration expenses.

Furthermore, the decision of the Court of Appeals is in acknowledged conflict with decisions of the Courts of Appeals for the First and Third Circuits, *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976), and *In re Public Ledger, Inc.*, 161 F.2d 762 (3d Cir. 1947). Those cases require the allocation of severance pay benefits and the classification of such benefits as a first priority administration expense only to the extent of actual employment during the Chapter XI period.* Since this conflict will continue to exist under the new Code, future treatment of severance pay benefits will vary according to the district where a debtor files its petition, and benefits will be enhanced or diminished by a debtor's choice of forum.

* Another court has recently addressed the issue. A Bankruptcy Court in the Seventh Circuit carefully reviewed the decisions of the First, Second and Third Circuits and concluded that the rationale of the First and Third was "far superior to that in *Straus-Duparquet, Inc.*" *In re Diamond Reo Trucks, Inc.*, 20 Collier Bankr. Cases 1130, 1138 (W.D. Mich. 1979).

Resolution of the issue is above all important for the efficient administration of the affairs of insolvent corporate debtors, whether in reorganization or liquidation. Corporate reorganization petitions have averaged some 4,000 petitions per year in recent years, with the bankruptcy courts administering billions of dollars in corporate assets.* Such a clear dispute in Circuit Court authority will inevitably generate controversy in the courts on the treatment of severance pay in any major corporate insolvency, whatever the composition of the class of general creditors. Confusion and court delay serve neither the interest of employees nor the interests of creditors as a whole, whether they are banks, trade creditors, holders of public debt, or any of the other people or entities who regularly extend credit to corporate employers.

I

The Decision Below Undermines Bankruptcy's Fundamental Concept and Legislative Scheme of Equality of Distribution.

The fundamental concept of bankruptcy is equality of asset distribution among creditors, all of whom must take some loss on their transactions but each of whom may thus share the loss in common with all other creditors. The few exceptions for priority claims provided in the Act and in the new Code are exceptions which are carefully limited, precisely because they run counter to the rule of equality of distribution. The exception having first priority, that for costs and expenses of administration, is restricted to

* *See, e.g.*, Table F-2 (Voluntary and Involuntary Filings) in the Annual Reports of the Director of the Administrative Office of the United States Courts for the years 1976 through 1978. The inclusion of non-corporate merchant and manufacturing bankruptcies more than doubles this figure. *Id.*, Table F-3.

those claims which arise during the period of reorganization and which, in the language of the Act, "includ[e] the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition."

Costs and expenses of administration are therefore paid in full before any other creditor receives anything, even including other priority creditors. The reason is that, if a reorganization bankruptcy is to have any chance of success, those dealing with the debtor-in-possession must know that obligations incurred by the ailing company during the reorganization have a realistic chance of payment. Any other rule would preclude the day-to-day functioning of the debtor and its collapse would be virtually assured.

Administration priority has thus consistently been held to apply only to items which have to be paid in order for the debtor to operate while it attempts to deal with its prepetition creditors. Examples are rent for the reasonable use and occupancy of premises after the filing of the petition, *e.g., In re Polaris Industries, Inc.*, [1973-1975 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 65,082 (D. Tenn. 1974); warehouse space for post-filing storage, *e.g., In re Walsh*, [1973-1975 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 65,349 (W.D. Wis. 1973); insurance during a receivership to cover loss of assets, *e.g., In re Ruffsdale Distilling Co.*, [1938-1941 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 52,773 (E.D. Pa. 1940); and utility bills for electricity supplied after the filing, *e.g., Wheeling Electric Co.* v. *Mead*, 177 F.2d 718 (4th Cir. 1949). The rationale of these and many similar cases is the actual need to expend some guarded portion of the funds of the bankrupt in order to preserve or administer the limited resources left after a bankruptcy filing.

The same rationale has been consistently followed in all areas of wages, with the sole exception of severance pay, and even there only in the Second Circuit. Wages themselves are paid as administration expenses solely for work performed after the filing, *e.g., In re Le Maire Machine Tool Co.*, [1962-1966 Transfer Binder] Bankr. L. Rep. (CCH) ¶ 61,577 (E.D. Mich. 1965). Vacation pay is an administration expense only for vacation earned post-filing, *e.g., In re Capital Services, Inc.*, 136 F. Supp. 430 (N.D. Cal. 1956)* The compensation of attorneys, accountants and other professionals retained by the bankrupt is paid as an administration expense only for what they do after filing, *e.g., In re Rothman*, 14 F. Supp. 241 (S.D.N.Y. 1936).

Even the tax withholding portions of wage payments are generally accorded first priority treatment only to the extent that the underlying wages are for post-filing services, *e.g., Pomper* v. *United States*, 196 F.2d 211 (2d Cir. 1952). In that case the Second Circuit rejected the government's contention that a full year's unemployment tax was entitled to administration priority because it happened to accrue after the date of the debtor's Chapter XI filing:

> "The employer's tax [on wages] at any given time in the taxable period can be accurately computed through multiplying by [the applicable tax rate] the aggregate wages paid to employees up to that time. The mere fact that the tax is not due until the year's end does not detract from the fact that it is incurred in a readily ascertainable amount as the wages are paid out . . . . Such a flexibility in computing and dividing the annual payroll tax . . . is not compatible with the United States' contention that, because the tax is imposed for a 'taxable year' or 'calendar year,' it is an inherently unsplit-upable unit." 196 F.2d at 213.

There is no reason to treat severance pay any differently. Earned over many years' employment in amounts

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* Indeed, vacation pay to Grant's employees was authorized on an allocated basis at the same hearing at which the Bankruptcy Court considered severance pay claims, in accordance with the Second Circuit's rule for the allocation of vacation pay in *Straus-Duparquet*. *See* Appendix III at 30a-31a.

directly related to service with the company long preceding the reorganization period, it cannot be said to constitute funds necessarily expended in order to preserve or administer a bankrupt's limited resources.

Indeed, there is an affirmative reason why severance pay should not be held to accrue all at the moment of termination. As this case demonstrates, severance pay can be a substantial obligation of the debtor. The Second Circuit's rule means that it is an obligation which will always have to be paid in full if a debtor does not terminate its employees prior to filing, thereby "accruing" the debt before the filing date. This is unworkable as a practical matter for a company needing the protection of bankruptcy for rehabilitation. Under the Second Circuit rule, if employees are kept one day past filing, their severance pay is automatically an administration expense in its entirety. Thus, the debtor must immediately opt between wholesale firings and assumption of a massive and possible crippling burden.

The Second Circuit exacerbated the dilemma by adopting the District Court's suggestion that Grant realized it might have lost its entire work force, defeating any hope for rehabilitation, had it announced at once that no severance pay would be recognized after the Chapter XI filing (Appendix I at 5a). That suggestion runs contrary to logic and human nature and has no support in the record. Employees continuing to earn full salaries stay with a troubled company like Grant to keep their jobs and to avoid being out of work. The fact that a portion of severance pay may be paid less than 100% in the event of liquidation is of minor importance.

If as a matter of policy the former employees of a failed company are to be given such extraordinary special treatment, that is a matter for legislation. Indeed, there is such legislation: both the Act, in Section 64a(2), and the new Code, in Section 507(a)(3), explicitly provide a lower priority for wages and certain employee benefits,

including explicit reference to severance pay in the latter. Under the rule enunciated by the Second Circuit, however, that legislation is ignored.*

II

The Decision Below Conflicts With Decisions of the Courts of Appeals for the First and Third Circuits.

In its decision below, the Second Circuit refused to depart from its earlier decision in *Straus-Duparquet, Inc.* v. *Local No. 3, IBEW*, 386 F.2d 649 (2d Cir. 1967). There the court had held, as a matter of first impression in the Second Circuit but contrary to precedent elsewhere, that severance pay accrued entirely upon an employee's termination and therefore such pay, when based on discharge after a Chapter XI filing, was payable in full as an expense of administration.

In *Straus-Duparquet,* such a result carried a certain equitable force. Forty-three terminated employees had been employed at one unprofitable division of the company. Their severance pay claims amounted to $8,069.41. The division was shut down in 1965 and the employees were let go, but there was no other shut-down of the business, no full-scale liquidation of assets to salvage some percentage for creditors, and the company had emerged from a suc-

* According to the legislative history, Congress believed it was codifying existing law in enacting the Code provisions on severance pay and explicitly linking those provisions to allocation. In the relevant hearings, subcommittee witnesses described severance pay as being "similarly calculated" to vacation pay, citing allocation examples. 10 Resnick and Wypyski, Bankruptcy Reform Act of 1978—A Legislative History (1979) at 297 ("Statements before the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary"). Similarly, the inclusion of severance pay among the third priority claims under Section 507 was considered to be an "expansion" of existing law, indicating that Congress contemplated allocation of severance pay claims. Report of the Committee on the Judiciary, House Report No. 95-595 (Sept. 8, 1977) at 357, *reprinted in* [1978] U.S. Code & Cong. Ad. News. vol. 5, p. 6313.

cessful reorganization by the time the matter reached the District Court in 1966. The rest of the employees stayed on with their vacation and severance pay and other benefits, and indeed their jobs, unaffected.

Unlike the Grant bankruptcy, where everyone has been let go, the few terminated employees in *Straus-Duparquet* would have received grossly unequal treatment if their severance pay had been allocated. Preserving their severance pay in full helped to keep them on a parity with employees who had been retained.*

With its decision below, the Second Circuit has stretched the *Straus-Duparquet* rule to the farthest extent, beyond that permitted by the Bankruptcy Act or any equitable considerations, to the point where it cannot be reconciled with decisions in other Circuits, as the Second Circuit acknowledged in its opinion.

In re Mammoth Mart, Inc., 536 F.2d 950 (1st Cir. 1976), which the Second Circuit refused to follow, had criticized and rejected the rule set down in *Straus-Duparquet*. 536 F.2d at 953. Like Grant, Mammoth Mart radically con-

* In the Second Circuit progeny of *Straus-Duparquet, In re The Bohack Corp.*, 535 F.2d 1240 (2d Cir. 1975), *cert. denied*, 425 U.S. 966 (1976), and *In re Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977), that court adhered to its rule. Neither *Bohack* nor *Unishops*, however, was a terminal Chapter XI situation. In *Bohack* the court upheld the applicability of *Straus-Duparquet* to the termination of particular union employees discharged in an effort to rehabilitate the company. The petition for certiorari in *Bohack*, which was denied on May 3, 1976, relied mainly on the conflict with the decision of the Bankruptcy Court in the First Circuit in *In re Mammoth Mart*. The First Circuit itself did not hand down its decision in *Mammoth Mart* until June 18, 1976. Even so, Justices Stewart, White and Blackmun voted to grant certiorari in *Bohack*. 425 U.S. at 966. In *Unishops*, the court noted in dictum that *Straus-Duparquet* stood for the proposition that severance pay is "usually an expense of administration in a Chapter XI case." 553 F.2d at 308 n.1. *Unishops* involved an employment contract for only a single executive, and the company did better by paying severance pay than it would have by honoring the full contract.

tracted its retail chain during the Chapter XI period, in the process discharging a large number of employees who had earned severance pay in amounts dependent on each employee's period of service. The discharged employees there received the full amount of the portion of their severance pay allocable to the Chapter XI period. But they came back and sought first priority treatment for the pre-filing portion on the basis of *Straus-Duparquet*. Pointing out that "no part of [the pre-filing] claims arises from services performed for the debtor-in-possession," the First Circuit refused to allow first priority to the prepetition part:

> "[A] debt is not entitled to priority as a cost and expense of administration simply because the claimant's right to payment arises after the debtor-in-possession has taken some action. . . . It is only when the debtor-in-possession's actions themselves—that is, considered apart from any obligation of the debtor—give rise to a legal liability that the claimant is entitled to [administration expense] priority." 536 F.2d at 955.

The First Circuit went on to state that it "strongly doubt[ed]" that the contrary rule of *Straus-Duparquet* is consistent with "§ 64a(2)'s provision [for] wages earned during the three months prior to the filing of the petition. . . ."

> "The [Straus-Duparquet] rule would undermine . . . the Congressional scheme. Under it, individuals could, based solely on their relationship with the debtor, recover 'severance pay' in excess of $600 and subject to no maximum. Moreover, they would recover these claims ahead of bona fide wage claims of other former employees (possibly exhausting the bankrupt's assets in doing so). . . ." 536 F.2d at 955-56.

The First Circuit in *Mammoth Mart* relied on *In re Public Ledger, Inc.*, 161 F.2d 762 (3d Cir. 1947). In *Public Ledger*, there were two employment contracts at issue. One provided for severance pay as an alternative to notice, without reference to length of service. In that instance the Third Circuit held that severance pay accrued entirely on termination without notice and so was entitled to administration expense priority. Under the second contract, however, severance pay was predicated on longevity of service, and so the amount earned each day was held to "mature in time to the status of a due debt," 161 F.2d at 773. Accordingly, the Third Circuit held that the priority components of each claim were to be prorated on a daily basis according to the period when the right to a portion of severance pay was earned. *Id.*

The Bankruptcy Court for the Western District of Michigan has recently evaluated the conflict among the Circuits as follows:

> "I believe the rationale set forth in *In re Public Ledger*, supra, and *In re Mammoth Mart, Inc.*, supra, to be far superior to that in *In re Straus-Duparquet, Inc.*, supra. The purpose of a Chapter XI proceedings is to rehabilitate the debtor. Creditors who deal with the debtor-in-possession are accorded a priority as an administrative expense under Section 64a(1). To accord employees who accrue benefits throughout their term of employment the same status for all accumulated benefits simply because they are terminated during the Chapter proceedings is unfair to other creditors who dealt with the debtor before and during the proceedings. Congress has accorded employees protection for wages under Sec. 64a(2), albeit somewhat conservative. This ha[s] been cured to a large extent under the new Bankruptcy Act which takes effect on October 1, 1979, and accords priority status to a maximum of

> $2,000.00, Section 507, 11 U.S.C. Sec. 507." *In re Diamond Reo Trucks, Inc.*, 20 Collier Bankr. Cases 1130, 1138 (W.D. Mich. 1979)

The Bankruptcy Court and the District Court below were bound by the Second Circuit decision in *Straus-Duparquet* and so did not have the flexibility of the court in *Diamond Reo*. The Bankruptcy Court below nevertheless saw fit to comment that the *Mammoth Mart* approach was "appealing" and "consistent with the equitable principles of the Bankruptcy Act" (Appendix III at 28a).

We submit that the Second Circuit's rule is incorrect—both unworkable as a tool of debtor protection and contrary to the mandate of the Act and the new Code. Allocation is consistent with the law in other Circuits, with the language of the Code and with the concept of administration priorities.

CONCLUSION

Because of the effect of this decision on bankruptcy administration and the conflict among the Circuits, petitioner Morgan Guaranty Trust Company of New York prays that a writ of certiorari issue to review the judgment of the Court of Appeals.

Dated: New York, New York
March 17, 1980

Respectfully submitted,

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Supreme Court, U. S.
FILED
MAR 18 1980
MICHAEL RODAK, JR., CLERK

79-1458

79-1459

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1979

No.

CHARLES G. RODMAN, as Trustee of the Estate of W. T. Grant Company, Bankrupt, and
MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
Petitioners,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt; ANSWERING EMPLOYEES OF BANKRUPT; LOCAL 807-IBT; RETAIL CLERKS INTERNATIONAL ASSOCIATION; and NATIONAL LABOR RELATIONS BOARD,
Respondents.

JOINT APPENDIX TO PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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JOINT APPENDIX

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Note: The appendix material contained in this Joint Appendix is filed on behalf of both petitioner Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt, and petitioner Morgan Guaranty Trust Company.

APPENDIX I

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of Bridgeport, on the 3rd day of January, one thousand nine hundred and eighty.

Present:

HON. WILLIAM H. TIMBERS

HON. THOMAS J. MESKILL

Circuit Judges

HON. LLOYD F. MACMAHON

United States District Judge

Sitting by Designation

UNITED STATES COURT OF APPEALS
Filed
Jan 03 1980
A. Daniel Fusaro,
Clerk
SECOND CIRCUIT

In re W. T. GRANT COMPANY, *Bankrupt.*
CHARLES G. RODMAN, as Trustee of the Estate of W. T. Grant Company, Bankrupt, and MORGAN GUARANTY TRUST COMPANY OF NEW YORK,

Petitioners-Appellants,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt, ANSWERING EMPLOYEES OF BANKRUPT, LOCAL 807-IBT, RETAIL CLERKS INTERNATIONAL ASSOCIATION, NATIONAL LABOR RELATIONS BOARD,

Respondents-Appellees.

Docket Nos. 79-5046 and 79-5047

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is *affirmed* substantially for the reasons set forth in District Judge Duffy's opinion of July 18, 1979 and Bankruptcy Judge Galgay's opinion of June 22, 1978, supplemented by the following statement of ours.

This appeal arises from the severance pay claims of over 32,000 former employees of W. T. Grant Co., which, having filed a Chapter XI petition for an arrangement on October 2, 1975, was adjudicated a bankrupt on April 13, 1976. We find the dispositive questions on appeal to be (1) whether Grant, as debtor-in-possession, rejected the executory contracts of its employees, and (2) whether the severance pay claims arising from those contracts are entitled to first priority as costs and expenses of administration.

We answer the first question in the negative. Under "the decisions in this Circuit . . . an executory contract is binding on the debtor in possession if it receives benefits under it." *In re Unishops, Inc.*, 553 F.2d 305, 309 (2 Cir. 1977) (Medina, J.). Here, Grant received benefits under the contracts by permitting the workers to continue in its employ after it entered Chapter XI. As the district court stated, Grant secured "the services of an experienced Grant personnel during the Chapter XI proceeding. Apparently, had Grant been forced to terminate all its employees upon entering Chapter XI and therefore recruit a new work force, even its short-lived Chapter XI attempt would have been virtually impossible."

The Trustee argues that Grant rejected the executory contracts by posting notices in its stores that it was discontinuing the severance pay benefits. We agree with the

bankruptcy and district courts, however, that only a formal rejection pursuant to § 313(1) of the Bankruptcy Act, 11 U.S.C. § 713(1) (1976), is sufficient to disaffirm an executory contract. *See In re Unishops, Inc., supra,* 553 F.2d at 308.

Turning to the second question before us, we reaffirm and adhere to our decision in *Straus-Duparquet, Inc.* v. *Local Union No. 3 International Brotherhood of Electrical Workers,* 386 F.2d 649 (2 Cir. 1967), and hold that the entire portion of the employees' severance pay claims is entitled to first priority as costs and expenses of administration.

The Trustee argues that severance claims should be given a priority only to the extent benefits were conferred upon Grant during the aborted Chapter XI proceeding. He further argues that severance pay, like wages, is earned from day to day, and that the amount of severance pay increases as the employee's tenure increases. The Trustee therefore asserts that the only portion of the severance pay claim that conferred a benefit upon Grant during the Chapter XI proceeding is that which accrued subsequent to the filing of the Chapter XI petition. Only this portion of the severance claim, the Trustee urges, is entitled to priority.

As the courts below recognized, *Straus-Duparquet* forecloses this argument. There we held that severance pay is not earned from day to day and unlike wages does not accrue. Appellants attempt to distinguish *Straus-Duparquet* on the ground that there the Chapter XI proceeding was successful and that only a small portion of the work force was released. Nowhere in *Straus-Duparquet* did we expressly or inferentially predicate our holding on those facts. Instead, our decision turned on our definition of severance pay as compensation for termination, as opposed to a form of wages that accrues from day to day.

Finally, in the alternative, appellants urge that, if *Straus-Duparquet* is fatal to their claim, we should over-

rule that decision since other courts have declined to follow it. *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1 Cir. 1976); *In re Diamond Reo Trucks, Inc.*, No. 74-1788 B 5 (W.D. Mich. June 19, 1979). Our Court, however, repeatedly has followed *Straus-Duparquet. See, e.g., In re Unishops, Inc., supra; In re Bohack Corp.*, 535 F.2d 1240 (2 Cir. 1975), (memorandum order), *cert. denied*, 425 U.S. 966 (1976). In our opinion the rationale of *Straus-Duparquet*—that severance pay is compensation—is sound. We decline appellants' invitation to overrule *Straus-Duparquet*, which remains the law of this Circuit.

Affirmed.

/s/ William H. Timbers
William H. Timbers

/s/ Thomas J. Meskill
Thomas J. Meskill
Circuit Judges

/s/ Lloyd F. MacMahon
Lloyd F. MacMahon
United States District Judge
Sitting by Designation

APPENDIX II

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re
W. T. GRANT COMPANY,
Bankrupt.

CHARLES G. RODMAN, as Trustee of the Estate of W. T. GRANT COMPANY, Bankrupt, and MORGAN GUARANTY TRUST COMPANY OF NEW YORK,
Appellants,

–against–

ALTON RINIER, as agent for certain employees of Bankrupt, ANSWERING EMPLOYEES OF BANKRUPT, LOCAL 807-IBT, RETAIL CLERKS INTERNATIONAL ASSOCIATION, NATIONAL LABOR RELATIONS BOARD,
Appellees.

UNITED STATES
DISTRICT COURT
Filed
Jul 18 1979
12:44 p.m.
S. D. of N. Y.

Bankruptcy No.
75 B 1735
(KTD)
OPINION

APPEARANCES:

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KEVIN THOMAS DUFFY, D.J.:

This is an appeal from an order of the Honorable John J. Galgay, Bankruptcy Judge, entered June 22, 1978, concerning the treatment and disposition of certain claims filed against the bankrupt estate of the W. T. Grant Company [hereinafter referred to as "Grant"]. In particular, the order addresses the claims of former Grant employees who qualified for severance benefits and who continued to work for Grant during its unsuccessful attempt at an arrangement under Chapter XI of the Bankruptcy Act [hereinafter sometimes referred to as the "Act"]. Judge Galgay directed that these claims be treated as a cost and expense of the unsuccessful Chapter XI proceeding and pursuant to Section 64(a)(1) of the Act, entitled to full payment as a first priority. The appellants, Charles G. Rodman as Trustee of Grant's estate [hereinafter referred

to as the "Trustee"], and Morgan Guaranty Trust Company of New York on behalf of itself and as agent for other bank claimants, object to this priority treatment and have filed the instant appeal.

On October 2, 1975, Grant filed a petition for an arrangement under Chapter XI of the Act. Thereafter, by order of the Bankruptcy Court dated April 13, 1976, Grant was adjudicated a bankrupt.

Prior to the Chapter XI proceeding, Grant was the operator and manager of over 1,000 retail outlets. In order to induce individuals to accept employment with Grant, it offered potential employees a wage and compensation package which included the receipt of severance pay benefits. The severance pay benefit plans for Grant employees are set forth in the Grant Store Manual, New York Office Supervisor's Personnel Manual, District Manager's Guide to Termination Policy and Procedure and approximately 53 Collective Bargaining Agreements between Grant and various union representatives. See Trustee's Exhibits 1A, 3, 7 and 12A; Retail Clerks International Association's [hereinafter referred to as "RCIA"] Exhibit A. Despite minor variations the agreements generally provide that a worker who meets a minimum "length of service" requirement (generally one year), is, upon termination, entitled to a severance payment. The precise amount of the payment is determined by the number of years the worker was employed by Grant and his weekly salary at the date of termination. For example, under the typical plan a worker employed for two years would receive one week's pay whereas an employee with five years of service would receive two weeks' pay.

Upon the filing of its petition on October 2, 1975, Grant, pursuant to Section 342 of the Act, became a debtor-in-possession and was expressly authorized to operate and manage its retail outlets. Thereafter, during the unsuccessful Chapter XI proceeding, many of Grant's retail outlets

were liquidated and its employees terminated. Finally, in April 1976, Grant was adjudicated a bankrupt and its remaining retail outlets were liquidated and the balance of its work force terminated. As a result, approximately 32,000 employees who were employed during the aborted Chapter XI proceeding and were eventually terminated have filed claims for severance pay benefits. It has been estimated that these claims when finally computed will be in excess of 11 million dollars.

Section 64 of the Bankruptcy Act dictates that certain debts of a bankrupt shall have priority over other debts. It provides:

> The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the costs and expenses of administration . . . (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding. . . .

The Trustee, in his application for instructions as to the treatment and disposition of claims filed against the bankrupt estate, characterized the claims for severance pay as part of the wages earned by Grant employees.[1] He recommended, therefore, that each severance claim be divided into three categories and paid accordingly. First, that portion of an employee's severance claim which accrued subsequent to the filing of the Chapter XI petition would be fully paid as an expense of administration under Section 64(a)(1) of the Act. Second, that portion of an employee's severance claim which accrued during the three months prior to the filing of the Chapter XI petition, not exceeding $600, would be paid as a secondary priority claim under Section 64(a)(2). The balance of the claim would be treated as a pre-Chapter XI non-priority unsecured wage claim.

The claimants,[2] however, argue that severance pay benefits are not akin to wages but rather are a form of compensation for the termination of the employment relationship. They urge that a claim for severance pay does not lend itself to the type of tortured division the Trustee would subject it to. They conclude, therefore, that those employees who continued to work for Grant during the unsuccessful Chapter XI proceeding are entitled to have their entire severance claim treated as a cost and expense of administration.

Judge Galgay adopted the claimants' reasoning. He found that despite contrary authority in other Circuits, under the clear pronouncements of the Second Circuit severance pay is not earned from day to day and unlike wages does not accrue. Accordingly he found that the severance claims for those individuals who continued to work for Grant during the Chapter XI proceeding were not divisible as suggested by the Trustee and were fully payable as a cost and expense of administration. In addition, Judge Galgay found that although Grant, as debtor-in-possession, had the power to reject the severance provisions as executory contracts, it failed to formally do so and consequently the severance provisions survived the Chapter XI proceeding.

There can be no doubt that in this Circuit severance pay benefits guaranteed under a collective bargaining agreement are not to be construed as wages. Indeed, in *Straus-Duparquet, Inc.* v. *Local Union No. 3 International Brotherhood of Electrical Workers,* 386 F.2d 649 (2d Cir. 1967) this Circuit defined severance benefits as

> a form of compensation for the termination of the employment relation, for reasons other than the displaced employees' misconduct, primarily to alleviate the consequent need for economic readjustment but also to recompense him for certain losses attributable to the dismissal.

Id. at 651. The Court went on to hold that "[s]everance pay is not earned from day to day and does not 'accrue' so that a proportionate part is payable under any circumstances." *Id.* The Court concluded that since severance pay is a form of compensation for termination of the employer-employee relationship, where the termination is an incident of the administration of a bankrupt's estate, the payments are entitled to a priority as an expense of administration. *Id. See also In re Unishops, Inc.*, 553 F.2d 305, 308 n.1 (2d Cir. 1977). Thus, insofar as those employees were entitled to severance pay benefits pursuant to the several collective bargaining agreements involved herein, their severance claims are not divisible as suggested by the Trustee. Consequently, absent a rejection of these executory agreements by the Trustee, these claims for severance pay are entitled to a priority.

The law, however, is somewhat less clear with respect to individual severance pay agreements. In the leading case, *Unishops, supra,* 553 F.2d 305, the Court was presented with a letter agreement between a corporation and one of its executive officers concerning severance pay benefits. After eleven years of service Unishops' Chief Operating Officer was promised by the corporation that upon termination he would be entitled to a $100,000 severance payment. Just eight months after the agreement, in November 1973, Unishops filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. Thereafter, Unishops continued to run its operation as a debtor-in-possession. The individual continued to act as Chief Operating Officer at Unishops until July 1974 when he was discharged.

The Court found that since the officer had continued in Unishops' employ for some time after it entered Chapter XI, and since the debtor-in-possession never rejected the executory severance agreement, Unishops received benefits under the contract and hence he was entitled to a priority

under Section 64(a)(1) of the Act. The confusion arises, however, in a footnote to the Court's decision where it is stated that while those "cases involving severance pay under collective bargaining contracts, such as *Straus-Duparquet, Inc.* v. *Local Union No. 3, supra,* 386 F.2d 649 (2d Cir. 1967), correctly define severance pay as compensation for termination of employment and hence usually an expense of administration, . . . *they are not determinative of the issue before us.*" *Id.* at 308 n.1 (emphasis supplied).

The Trustee urges that the above quoted language indiccates that although severance benefits under a collective bargaining agreement are to be construed as compensation for termination, individual severance pay agreements are not to be so classified. I disagree.

A reading of the *Unishops'* decision indicates that the issue before the Court was not the classification of severance benefits as either wages or termination compensation, but rather whether the debtor-in-possession ever rejected the executory severance as authorized under the Bankruptcy Act. Consequently, the *Straus-Duparquet* doctrine was simply "not determinative" of the issue before the *Unishops'* Court. Nowhere did the Court indicate, as the Trustee suggests, that the *Straus-Duparquet* doctrine was somehow inapplicable. Moreover, there appears to be no sound reason why the doctrine should not apply with equal force to individual severance agreements. Indeed, the nature of severance benefits is not altered simply because entitlement to the benefits originates in an individual employment contract as opposed to a collective bargaining agreement. Suffice it to say that in the case at bar the individual severance agreements were in no sense intended to represent compensation for services rendered or to be rendered by Grant employees. In fact, individual agreements were virtually identical to those contained in the collective bargaining agreements and could only be intended as compensation for termination. Accordingly, those severance

claims arising out of individual employment agreements must stand on the same ground as those emanating from collective bargaining agreements.[3]

This determination, however, does not end our inquiry. It is clear that the Bankruptcy Act permits a debtor-in-possession to reject executory contracts. See, e.g., 11 U.S.C. §§ 313(1), 357(2) and Chapter XI rule 11-53, 415 U.S. 1036 (1974).[4] *See also in re Unishops, supra,* 553 F.2d at 308. However, this Circuit has held that

> [a] debtor in possession . . . may disaffirm or reject an executory agreement *only in accordance with the statutory procedures.* As stated in the leading treatise,
>
> > 'The failure to assume affirmatively an executory contract does not result at any time in a rejection of the contract. Whether the debtor is in possession, or whether there is a receiver or trustee, the contract can be rejected *only by affirmative action under § 313(1) and Chapter XI Rule 11-53 or § 357(2). Unless so rejected, the contract continues in effect.'*

Id. at 308 (emphasis added). Thus, the issue is whether Grant ever rejected the executory severance agreements while it acted as debtor-in-possession.

It is undisputed that Grant did not affirmatively reject the agreements in issue pursuant to the statutory provisions of the Bankruptcy Act. The Trustee argues, however, that a debtor-in-possession is a separate and distinct juridical entity from that of the pre-Chapter XI debtor and as such is not bound by the agreements of the debtor absent an affirmative assumption thereof. He concludes that since Grant made no such affirmation of the severance agreements during the Chapter XI proceeding, it is not bound by the agreements. Alternatively, the Trustee argues that Grant's conduct upon commencement of the Chapter XI proceeding

was sufficient under the circumstances to reject the severance agreements. Finally, the Trustee urges that should the severance claims be deemed as a cost and expense of administration, the amount of each claim must be limited to the actual value of the benefits conferred upon the debtor-in-possession during the Chapter XI proceeding. I find these arguments to be inapposite.

There is no doubt that a debtor-in-possession is deemed to be an entity separate and distinct from the debtor. *See, e.g., Truck Drivers Local No. 807* v. *Bohack Corp.,* 541 F.2d 312 (2d Cir. 1976); *Brotherhood of Railway, etc.* v. *REA Express, Inc.,* 523 F.2d 164 (2d Cir.), *cert. denied,* 423 U.S. 1017, 1073 (1975-76); *Shopman's Local No. 455 etc.* v. *Kevin Steel Products, Inc.,* 519 F.2d 698 (2d Cir. 1975). It is equally settled, however, that a claim arising under an executory contract is entitled to a priority as a cost and expense of administration "if the trustee or debtor in possession elects to assume the contract *or if he receives benefits under it.*" *Unishops, supra,* 553 F.2d at 308 (emphasis added). Consequently, a formal assumption of the contract is unnecessary where the debtor-in-possession reaps the benefits of the contract during a Chapter XI proceeding.

In the instant action, Grant never formally assumed the executory contracts in issue. However, it did permit its employees, covered by the severance agreements, to continue in its employ after it entered Chapter XI. Hence, at the very least Grant received benefits under the executory contracts by virtue of securing the services of experienced Grant personnel during the Chapter XI proceeding. Apparently, had Grant been forced to terminate all its employees upon entering Chapter XI and thereafter recruit a new work force, even its short-lived Chapter XI attempt would have been virtually impossible. Accordingly, in light of these benefits the severance claims of the employees were entitled to a priority as a cost and expense of administration. *Unishops, supra,* 553 F.2d 308. This is true

despite Grant's "good faith attempt to reject the executory contracts formally binding upon the debtor." See Judge Galgay's memorandum opinion at page 5. As Judge Galgay correctly held, only a formal and affirmative rejection pursuant to Sections 313(1), 357(2) of the Bankruptcy Act was sufficient to disaffirm the contracts herein. *Id.* Suffice it to say that Grant's efforts, short of a formal rejection, were insufficient to cause a rejection of the severance agreements herein.[5]

I turn finally to consider whether the Grant employees are entitled to recover 100 percent of their severance awards as a cost and expense of administration. The Trustee argues that since these claims were given priority treatment solely because Grant received benefits under the severance agreements during the Chapter XI proceeding, Judge Galgay erred in permitting 100 percent of each claim to be given a priority. Relying upon *American Anthracite & Bituminous Coal Corp.* v. *Leonardo Arrivabene, S.A.,* 280 F.2d 119 (2d Cir. 1960), the Trustee urges that a severance claim should be given a priority only to the extent benefits were conferred upon Grant during the aborted Chapter XI proceeding. In other words, rather than treating the entire severance claim as computed under the agreement as a cost and expense of administration, only the "reasonable value" of the benefits conferred upon Grant should be granted priority status.

While apparently supporting the Trustee's position, I believe the Second Circuit has recently retreated from that portion of its decision in *American Anthracite* which limits the priority to the reasonable value of the benefits conferred. Indeed, in *Unishops, supra,* the Court held that an employee's severance claim was entitled to be treated, without limitation, as a cost and expense of administration solely because the debtor-in-possession had received the benefits of the employee's services during the Chapter XI proceeding. The Court, while citing *American Anthracite,* made no

attempt to limit the claim to the value of the benefits conferred. Rather, the Court permitted the claimant to recover the full amount of severance pay guaranteed under the severance agreement as a cost and expense of administration. *Unishops, supra,* 553 F.2d at 308. I feel constrained by this later decision and accordingly affirm Judge Galgay's treatment of the severance claims.[6]

Accordingly, Judge Galgay's order is affirmed.

So Ordered.

/s/ Kevin Thomas Duffy
U. S. D. J.

Dated: New York, New York
July 18, 1979

FOOTNOTES

[1] It is important to note from the outset that at no time did an employee's right to severance pay vest prior to termination. Under the express terms of the several severance plans at bar, employees who voluntarily resigned or were terminated *for cause* were not entitled to severance payments. Consequently, the entitlement to severance pay was not finally determined until the day of termination.

[2] The claimants, appellees herein, consist of Alton L. Rinier, as common agent on behalf of former Grant employees, Answering Employees of the Bankrupt, Local 807-IBT, Retail Clerks International Association and the National Labor Relations Board. The sole distinction among these claimants is that while some are governed by the severance provisions contained in the over 53 Collective Bargaining Agreements between Grant and Union representatives (Trustee's Exhibit 7; RCIA's Exhibit A), the remaining non-union employees are governed by the severance provisions contained in the various Grant Store Manuals (Trustee's Exhibits 1A, 3 and 12A).

[3] The Trustee also seeks to avoid the *Straus-Duparquet* doctrine by arguing that it should be limited only to those cases in which a Chapter XI arrangement has been successful. I find this attempted limitation to be totally artificial and without merit.

[4] Section 713 of the Act provides:

> Upon the filing of a petition, the court may, in addition to the jurisdiction, powers, and duties conferred and imposed upon it by this chapter—
>
> (1) permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate;

Section 757 of the Act goes on to provide:

> An arrangement within the meaning of this chapter may include—
>
> (1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms;
>
> * * *

[5] *See also* In re Alfar Dairy, Inc., 458 F.2d 1258 (5th Cir.), *cert. denied*, 409 U.S. 1048 (1972). In *Alfar* the Court held that the Bankruptcy Act does not permit a "tacit" rejection of an executory contract. *Id.* at 1260. Consequently, "even though a party to an executory contract . . . may know by one means or another that the

bankrupt does not intend to perform, the contract is not voided as a result of this knowledge but remains in force until rejected pursuant to the Act." *Id.* at 1261.

[6] This result fully comports with this Circuit's decision in *Straus-Duparquet* holding that since severance pay is a form of compensation for termination of the employment relation rather than something that is earned from day to day, it is not capable of apportionment and the full severance award is payable upon termination. 386 F.2d at 651.

APPENDIX III

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter — of — W. T. GRANT COMPANY *Bankrupt.*	No. 75 B 1735 MEMORANDUM OPINION

JOHN J. GALGAY—*Bankruptcy Judge*

The trustee for the bankrupt estate of W.T. Grant Company has applied to this Court for instructions as to the treatment and disposition of claims filed against the bankrupt estate by former employees of Grant for severance pay benefits. The claims arose as a result of the petition filed by W.T. Grant Company on October 2, 1975 for an arrangement under Chapter XI, Sec. 322 of the Bankruptcy Act, 11 U.S.C. Sec. 722. Despite attempts to rehabilitate the operations and management of the retail chain, the company was adjudged a bankrupt by this court on April 13, 1976, compelling the liquidation of all retail outfits as well as the termination of employment of approximately 75,000 individuals.

Prior to the filing of the Chapter XI petition, Grant provided employees with a wage and compensation package which included the prospect of receiving severance pay benefits in the event of dismissal, dependent upon length of service with the company. As an employee's term of employment increased, the amount of his potential severance pay benefits for dismissal also increased. Subsequent to the filing of the Chapter XI petition, Grant as debtor-in-possession, notified its employees that severance pay benefits would be discontinued pending the development of a payment plan subject to the approval of this court. A total of 41,000 proofs of claim seeking severance pay benefits in

excess of $20,000,000 were eventually filed by employees against the bankrupt estate.

The issue raised in this proceeding questions whether severance pay benefits owed by the debtor-in-possession to employees who performed services for the bankrupt prior to the filing of the petition are to be treated as costs and expenses of administration which are entitled to full payment in an unlimited amount under Sec. 64(a)(1) of the Bankruptcy Act, 11 U.S.C. 104(a)(1).

The trustee characterizes the claims for severance pay benefits as part of the wages earned by each eligible employee during the course of his employment, with the right to and the amount of such benefits dependent upon the period of employment. Consequently, the trustee recommends that the claims be awarded on a pro-rata basis through the use of a per diem value established for the year preceding the termination of the particular employee. Accordingly, the portion of severance pay which has accrued subsequent to the filing of the Chapter XI petition would be paid as an expense of administration under Sec. 64(a)(1) of the Bankruptcy Act. The portion which had accrued in the three months prior to the filing of the Chapter XI petition not in excess of $600, would be paid as a second priority claim under Sec. 64(a)(2). The balance of the claim would be treated as a pre-Chapter XI non-priority unsecured wage claim. The trustee argues that the proposal fully conforms with the provisions of the Bankruptcy Act, provides fair and equitable treatment of all former employees and protects the interests of the other creditors of the bankrupt estate.

The case law governing the matter in question is beset by a sharp conflict between the circuits. Two circuits have held that only that portion of the severance pay claim which can be allocated to services performed by employees after the filing of the arrangement is entitled to first priority, *In*

re Mammoth Mart, Inc. 536 F.2d 950 (1st Cir. 1976); *In re Public Ledger* 161 F.2d 762 (3d Cir. 1947), whereas our circuit (the 2nd Circuit) has held that the entire amount of such a claim should be afforded Sec. 64(a)(1) treatment, *In re Straus-Duparquet, Inc.* 386 F.2d 649 (2d Cir. 1967). The trustee urges this court to embrace the law in the First and Third Circuits as an alternative to the position adopted by the Second Circuit in *In re Straus-Duparquet,* supra and its progeny.

The trustee argues that severance pay benefits owed by the debtor-in-possession to employees who performed services for the bankrupt prior to the commencement of the Chapter XI are not costs and expenses of administration entitled to full payment in an unlimited amount. This position is premised upon the fact that W.T. Grant Company, as debtor-in-possession under Chapter XI, became a new entity "with its own rights and duties, subject to the supervision of the Bankruptcy Court." *Shopmen's Local Union No. 455* v. *Kevin Steel Products, Inc.* 519 F.2d 698 (2d Cir. 1975); *Brotherhood of Railway Express* v. *REA Express, Inc.* 523 F.2d 164 (2d Cir. 1975), *cert. denied* 423 US 1017 (1976). See also *Allegaert* v. *Perot* 548 F.2d 432 (2d Cir. 1977). Thus, we must consider the legal rights of two separate and distinct juridical entities: the pre-petition debtor and the post-petition debtor-in-possession.

The fundamental role of the debtor-in-possession is rehabilitation of the financially troubled business. In furtherance of that goal, the debtor-in-possession is free to terminate unprofitable activities and reject burdensome executory contracts, see 11 U.S.C. Sec. 731(1). The Second Circuit has previously recognized that "(t)he claims of a creditor having an executory contract with the debtor at the time the debtor's petition is filed is entitled to priority under these provisions only if the trustee or debtor-in-possession elects to assume the contract or if he receives benefits under it." *American Anthracite & Bituminous Coal*

Corp. v. *Leonardo Arrivabene S.A., et al.* 280 F.2d 119 (2d Cir. 1960).

The trustee asserts that the executory wage contracts between the employees and the Grant Company were not adopted or assumed by the debtor-in-possession. The store closing manual prepared by the debtor-in-possession specifically stated in reference to termination pay that the company was developing a plan for the payment of termination or incentive pay in connection with store closings, which would be subject to the approval of the Bankruptcy Court. Furthermore, the debtor-in-possession distributed a notice posted in all stores which informed all employees of the policy to discontinue the payment of severance pay, pending an order of the Bankruptcy Court.

The evidence introduced by the debtor-in-possession clearly indicates a good faith attempt to reject the executory contracts formerly binding upon the debtor. However, the fact remains that the debtor-in-possession never did follow the formal rejection proceedings outlined in the Bankruptcy Act. This hybrid action can be contrasted with the steps taken by the debtor-in-possession in the *REA* bankruptcy to affirmatively reject the collective bargaining agreements binding upon the debtor.

The trustee rests his proposal for allocating severance pay upon the fact that the debtor-in-possession received benefits under the contract during the Chapter XI proceeding. The trustee asserts that the claims for severance pay benefits may be entitled to priority as costs and expenses of administration to the extent that the consideration supporting the claims was supplied during the reorganization: See *In re Mammoth Mart, Inc.*, supra. The First Circuit found in *Mammoth Mart* that the services performed for the debtor over the entire period of each claimant's employment constituted the consideration for the claims made. Since no part of the claims arose from services performed for *Mammoth Mart* as debtor-in-possession, no portion of the claims secured Sec. 64(a)(1) priority.

Similarly, in the case at hand, the amount of severance pay claims depends upon the length of employment and all of the services performed for W. T. Grant Company constitute consideration for the severance pay claims made. Consequently, the trustee proposes to allocate, as a first priority, the reasonable value of the benefits conferred upon the debtor-in-possession by each claimant.

The trustee asserts finally, that his proposal best satisfies the equitable principles governing the Bankruptcy Act. The Supreme Court stated that "(i)f one claimant is to be preferred over others, the purpose should be clear from the statute". *Nathanson* v. *NLRB* 344 U.S. 25, 29 (1952). The Trustee has questioned the statutory basis for affording the entire amount of a severance pay claim first priority treatment in light of the careful consideration Congress gave to the allocation of employee claims under Sec. 64(a)(2). The Trustee argues that his proposal best maintains the desired consistency between Sec. 64(a)(1) and 64(a)(2) of the Bankruptcy Act.

The former employees of Grant vigorously object to the trustee's proposal. The employees assert that payment of severance pay was fixed by rules and regulations of the Company which remained in force after the filing of the petition and are binding upon the debtor-in-possession. The applicable law recognizes severance pay as damages payable for termination of employment. Since termination occurred during a Chapter XI proceeding, the full amount of severance pay is owed by the debtor-in-possession as an expense of administration. The employees rely upon the controlling principles in *In re Straus-Duparquet, Inc.* 386 F.2d 649 (2d Cir. 1967) and its progeny, *In re Bohack* 535 F.2d 1240 (2d Cir. 1975) and *In re Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977).

The Court held in *Straus-Duparquet,* that "(s)everance pay is not earned from day to day and does not accrue so that a proportionate part is payable under any circumstances. After the period of eligibility is served, the full severance pay is due whenever termination of employment occurs." 386 F.2d 651. The former employees closely link the facts at hand to those in *Straus-Duparquet* and argue that since employment was terminated as an incident of the administration of the bankrupt's estate, severance pay is an expense of administration and is entitled to priority treatment.

Although this Court finds the logic of the First Circuit in *Mammoth Mart,* supra, appealing and the holding most consistent with the equitable principles in the Bankruptcy Act, we are bound by the controlling authority in the Second Circuit and therefore must apply the rationale of *Straus-Duparquet,* supra, to the matter in question. Circuit Judge Friendly aptly phrased this principle in his concurring opinion in *United States* v. *A Motion Picture Entitled "I am Curious Yellow"* 404 F.2d 196, 200 (2d Cir. 1968) where he stated; "our duty as an inferior federal court is to apply as best we can, the standards" of our superior courts.

Furthermore, the trustee's attempts to distinguish our facts from those in *Straus-Duparquet,* supra, and to align our issues more closely with *In re Mammoth Mart,* supra, lack sufficient merit. The First Circuit rejected a factual distinction between the two cases when it stated in *Mammoth Mart* that "implicit in the foregoing discussion, we find the reasoning in support of the contrary result in *Straus-Duparquet* . . . unpersuasive. There *(Straus-Duparquet)* the court concluded that severance pay claims similar to appellants' were entitled to first priority . . ." 536 F.2d at 955.

The fact that we are dealing primarily with non-union employment contracts instead of with a full scale union collective bargaining agreement or with an unsuccessful

Chapter XI proceeding instead of with a successful arrangement, are factors which a higher court may employ to further narrow the breadth of *Straus-Duparquet.* The Second Circuit first clarified the doctrine in *In re Unishops,* supra, footnote 1 (one) where it states that "(t)he cases involving severance pay under collective bargaining contracts, such as *Straus-Duparquet* correctly define severance pay as compensation for termination of employment and hence *usually* an expenses of administration, but they are not determinative of the issue before us." The court evidently has recognized that the facts and the equitable interests in particular situations do not require first priority treatment of severance pay claims. Further guidance however, is needed in this area.

In light of the foregoing findings of fact and conclusions of law, this court feels compelled to follow the direction of the Second Circuit and instructs the trustee to compute severance pay for each former employee of Grant discharged during the Chapter XI proceeding and to pay it in full as an expense of administration under Sec. 64(a)(1) of the Bankruptcy Act, 11 U.S.C. Sec. 104(a)(1).

Settle order in conformity with the foregoing.

Dated: New York, New York
June 22, 1978

/s/ JOHN J. GALGAY
Bankruptcy Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re W. T. GRANT COMPANY, *Bankrupt.*	Bankruptcy No. 75 B 1735

ORDER AUTHORIZING AND APPROVING PAYMENT OF SEVERANCE PAY BENEFITS

Upon the application of Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt (the "Trustee"), dated May 10, 1977, for instructions as to the disposition of claims made by former employees of W. T. Grant Company ("Grant"), other than former officers and directors, for vacation and severance pay benefits, the hearing held on June 28, 1977 to consider said application at which the appearances of interested parties were noted in the record, the objections interposed to the Trustee's recommendations and upon all of the proceedings had before the court, the decision and order dated June 7, 1978, directing the disposition and satisfaction of claims for vacation pay benefits, and the court having filed its written opinion dated June 22, 1978, as to the disposition and satisfaction of claims for severance pay benefits, and sufficient cause appearing therefor, it is

ORDERED that the portion of proofs of claim filed with the court by former employees of Grant who were discharged during the aborted Chapter XI case for severance pay benefits, other than former officers and directors, to the extent that the Trustee is hereafter authorized and directed by order of the court to make distributions from the assets of the bankrupt estate to satisfy such claims, upon the authority of *In re Straus-Duparquet, Inc.*, 386 F.2d 649 (2d Cir. 1967) and *In re Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977), be, and they hereby are, claims entitled to priority as costs and expenses of administration of the

aborted Chapter XI case under Section 64a(1) of the Bankruptcy Act, 11 U.S.C. § 104a(1), entitled to priority after the payment of the costs and expenses of the bankruptcy case under Chapters I-VII of the Bankruptcy Act; and it is further

ORDERED that the gross amount of such claims of former employees for severance pay benefits are to be calculated in accordance with the policies, procedures and practice of Grant or, where appropriate, its collective bargaining agreements, in effect or enforceable in respect of such benefits as of October 1, 1975 as described during the hearing held on June 28, 1977 and incorporated in the record of that hearing.

Dated: New York, New York
July 21, 1978

/s/ JOHN J. GALGAY
Bankruptcy Judge

APPENDIX IV

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

Filed
Jan 21 1980
Richard H. Deane
Clerk,
U.S. Court of Appeals

LOCAL JOINT EXECUTIVE BOARD, AFL-CIO, et al.,
Plaintiff-Appellant,

vs.

HOTEL CIRCLE, INC., et al.,
Defendant-Appellee.

No. 76-3066
OPINION

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA

Before: WRIGHT, WALLACE, and ANDERSON, *Circuit Judges*

WALLACE, *Circuit Judge:*

This appeal requires us to address tensions between the language and underlying policies of the Bankruptcy Act and the National Labor Relations Act (NLRA). The district court upheld the decision of the bankruptcy judge relieving Hotel Circle, Inc. (Hotel Circle) from the obligations of a collective bargaining agreement with Local Joint Executive Board, AFL-CIO (Union). *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc.*, 419 F. Supp. 778 (S.D. Cal. 1976). The Union alleges that the district court erred in defining the scope of section 313(1) of the Bankruptcy Act, 11 U.S.C. § 713(1), which allows the bankruptcy court to permit rejection of executory contracts of the debtor, and erred in holding that a bankruptcy receiver lacks authority to assume unilaterally or enter into long-term collective bargaining agreements. We affirm.

I

On October 10, 1974, Hotel Circle filed for protection under Chapter XI of the Bankruptcy Act, 11 U.S.C. §§ 701

et seq. After the Chapter XI petition was filed, the business was operated by the debtor in possession until a receiver was appointed on July 21, 1975. During this time, Hotel Circle continued to operate under a 1973 collective bargaining agreement between it and the Union, which was scheduled to expire in 1977. Hotel Circle was a member of the Restaurant-Hotel Employers' Council (Council), the multi-employer group which had negotiated the 1973 agreement. After its appointment, the receiver sent a representative to participate in discussions between the Council and the Union on the subject of modifying and extending the agreement. On August 18, 1975, the receiver's representative was among those who voted to accept a proposed wage increase and to extend the life of the existing agreement. Although not expressly indicating that he was bound by the renegotiated contract, the receiver paid the hotel's employees in accordance with the higher wage scale of the new agreement.

In the meantime, the receiver negotiated a proposed sale of the Le Baron Hotel, which sale was conditioned on the purchaser taking clear of any existing collective bargaining agreement. In December 1975 the receiver applied for an order authorizing sale of the hotel, and the Official Creditors' committee filed a motion seeking to reject various executory contracts, including the collective bargaining agreement between the Council and the Union. On December 15, 1975, the bankruptcy court authorized the sale of the hotel, and on January 6, 1976, the court issued an order rejecting the collective bargaining agreement.

The Union contends that the district court erred on several grounds in sustaining the decision of the bankruptcy judge allowing rejection of the agreement. First, it contends that the rejection provision of Chapter XI of the Bankruptcy Act, section 313(1), 11 U.S.C. § 713(1), should properly be read as excluding collective bargaining agreements because of their unique nature and the policies underlying the labor laws. Second, assuming the bankruptcy court may allow rejection of a collective bargaining agreement, the Union contends that the receiver had authority to affirm the agreement, thereby binding the estate, and did in fact affirm it by entering into negotiations for its modification and extension and by adopting its terms. The Union claims that the district court erroneously decided this issue because it improperly concluded that a receiver is not an "employer" under the NLRA. Finally, the Union contends that the receiver had authority to, and did in fact, enter into the modified agreement, arguing that this authority stemmed from his order of appointment from the bankruptcy court as well as from his duty to bargain under the NLRA. It also argues that the rejection provision relied on by the bankruptcy court to "reject" the modified agreement does not apply to contracts of the receiver. These contentions will be dealt with in turn.

II

We have never confronted the question whether section 313(1) of the Bankruptcy Act, 11 U.S.C. § 713(1), allowing the rejection of executory contracts of the debtor, applies to collective bargaining agreements. Acknowledging that the weight of authority is to the contrary, the Union urges us to find that such an agreement is not an "executory contract" for purposes of section 313(1).[1] The Union encourages us to construe the language of the Bankruptcy Act so that it would be consistent with the apparently absolute language of section 8(d) of the NLRA, 29 U.S.C. § 158(d), which requires certain procedures and conditions for the termination or modification of a collective bargaining agreement.

The NLRA should govern, according to the Union, because labor agreements are not ordinary executory contracts, but rather generalized codes for industrial peace. *John Wiley & Sons, Inc.* v. *Livingston,* 376 U.S. 543, 550

(1964); *United Steelworkers* v. *Warrior & Gulf Navigation Co.*, 363 U.S. 574, 578-80 (1960). The Union argues that the labor law policy of promoting industrial peace and stability for employees, *John Wiley & Sons, Inc.* v. *Livingston, supra,* 376 U.S. at 549, suggests that Congress did not intend to include labor agreements among the "executory contracts" that could be rejected under the Bankruptcy Act. It contends that this interpretation is further bolstered by the inadequacy of the Bankruptcy Act's remedy of actual damages for rejected contracts. Since many of the benefits of labor agreements are intangible, such agreements do not, according to this argument, lend themselves to damage measurement as would a commercial agreement.

These and other arguments were recently considered by the Second Circuit in *Shopmen's Local 455* v. *Kevin Steel Products, Inc.*, 519 F.2d 698 (2d Cir. 1975). That court held, consistent with prior district court cases, that section 313(1) applies to labor agreements. *See, e.g., Carpenter's Local 2746* v. *Turney Wood Products, Inc.*, 289 F. Supp. 143, 147-50 (W.D. Ark. 1968); *In re Overseas National Airways, Inc.*, 238 F. Supp. 359, 361 (E.D.N.Y. 1965); *In re Klaber Bros., Inc.* 173 F. Supp. 83, 85 (S.D.N.Y. 1959). The court in *Kevin Steel* relied in part on the unqualified statutory language of the Bankruptcy Act and on the fact that Congress had previously demonstrated its ability to carve labor agreements out of a general grant of power to reject executory contracts. 519 F.2d at 701-02. *See* Bankruptcy Act § 77(n), 11 U.S.C. § 205(n) (prohibiting bankruptcy court or trustees from changing wages or working conditions of railroad employees except in manner prescribed by Railway Labor Act). At the same time, the court acknowledged that "the issue is not a simple one to be decided only by a literal reading of section 313(1)." *Id.* at 703. Therefore, the Second Circuit examined the policies of the acts in question and determined, correctly we think, that the Bankruptcy Act's provisions were intended to prevail. The court stated that a debtor in possession or receiver under Chapter XI of the Bankruptcy Act is, in a real sense, not the same entity as the pre-bankruptcy company. It is "[a] new entity . . . with its own rights and duties, subject to the supervision of the bankruptcy court." *Id.* at 704. The court concluded that this new entity is not a "party" to the existing labor agreement for purposes of the section 8(d) termination restrictions, reasoning that to require the debtor-in-possession or receiver to assume an outstanding labor contract would place the new entity "in a worse position than a successor employer, who is generally not bound by the existing labor agreement. *See NLRB* v. *Burns Int'l Security Services, Inc.*, 406 U.S. 272, 281-91 (1972)." *Id.*[2]

We recognize, on the one hand, that this analysis is not inexorable and is based on a policy choice which emphasizes the changed status of the debtor in bankruptcy for purposes of analyzing its obligation under 8(d). The Second Circuit has acknowledged that *Kevin Steel* analogized the position of a receiver in bankruptcy to that of a successor employer, and thus reasoned that a receiver is not a "party" to the labor agreement, "for the narrow purpose of resolving otherwise conflicting provisions of the labor laws." *Truck Drivers Local 807* v. *Bohack Corp.*, 541 F.2d 312, 320 (2d Cir. 1976). On the other hand, we are convinced that the analogy to successorship cases in this limited area is valuable, and we agree that it would be anomalous to bind the receiver in reorganization proceedings when a successor employer is not bound. *See NLRB* v. *Burns Int'l Security Services, Inc., supra,* 406 U.S. at 287-88 (refusing to impose a labor agreement on successor employer in part bacause to do so might discourage needed transfers of capital). The policy of allowing a new start to a debtor in reorganization proceedings provides an even stronger reason for not automatically imposing the existing labor agreement than does the policy recognized in *Burns* of encouraging the flow of capital.

It is significant that in *Burns* the Supreme Court rejected the argument, analogously made here, that the unique nature of labor agreements and the policy of promoting stability for employees should overcome the corresponding rights and interests of a successor employer. The Court stressed that the cases relied on by the union there involved suits to compel arbitration and reflected " 'the preference of national labor policy for arbitration as a substitute for tests of strength between contending forces.' " *NLRB* v. *Burns Int'l Security Services, Inc., supra,* 406 U.S. at 286 (quoting *John Wiley & Sons, Inc.* v. *Livingston, supra,* 376 U.S. at 549).

Similarly, we conclude that the unique features of labor agreements do not overcome the plain language of the Bankruptcy Act and the policies embodied in Chapter XI proceedings. While we recognize that important employee interests are at stake when rejection of a labor agreement is considered, the policies of the Bankruptcy Act are designed to assist failing businesses, a goal in which employees ultimately have a stake as well. We do not believe that the power to reject labor agreements found to be onerous and burdensome to the debtor's estate is inconsistent with the policies of the labor laws.[3]

III

We now consider the contention that the receiver prevented the subsequent rejection of the collective bargaining agreement when he affirmed the contract and thereby bound the estate. First, we put to one side a sub-issue which we do not believe is dispositive of the main question. The Union contends that the district court failed to confront the tension between the NLRA and the Bankruptcy Act on this question because it misconstrued the status of a receiver under the labor laws. Relying on the *Kevin Steel* conclusion that a receiver is a new entity which is not a "party" to a labor agreement for section 8(d) purposes, the district court went

on to conclude that "[t]he bankruptcy entity is not an employer within the meaning of the National Labor Relations Act unless the entity becomes a party to the collective bargaining agreement." *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 785. The Union points to cases holding that receivers are employers under the labor laws and, as such, are liable for unfair labor practices and are obligated to bargain under the Act. *In re American Buslines,* 151 F. Supp. 877, 882 (D. Neb. 1957); *NLRB* v. *Baldwin Locomotives Works,* 128 F.2d 39, 43 (3d Cir. 1942); *NLRB* v. *Bachelder,* 120 F.2d 574, 576 (7th Cir.), *cert. denied,* 314 U.S. 647 (1941). As the Union observes, *Kevin Steel* also recognized that the new entity of a bankruptcy reorganization proceeding must comply generally with the NLRA. *Shopmen's Local 455* v. *Kevin Steel Products, Inc., supra,* 519 F.2d at 704.

While we agree that a receiver has the general duty to bargain and otherwise comply with the NLRA, we are not persuaded that the receiver's status as an employer is dispositive of the issue as to his authority to adopt a collective bargaining agreement. The receiver's duty to bargain does not imply that he possesses all of the power and responsibilities of a regular employer. Nor does it change the fact that he is an officer of the bankruptcy court possessing limited, strictly construed authority. *See, e.g., Chicago Deposit Vault Co.* v. *McNulta,* 153 U.S. 554, 561 (1894). Therefore, the fact that he has such a duty does not answer the question whether he may adopt a collective bargaining agreement without seeking the approval of the court.

We are compelled to reject the district judge's conclusion that a receiver is not an employer under the NLRA unless he becomes a "party" to the labor agreement, because that reasoning could lead to confusion if applied outside this limited area of agreement adoption. We believe, however, that he accurately considered the legal authorities relating to the power of receivers to assume executory agreements

and appropriately reconciled the demands of the bankruptcy and labor acts. We thus read the district court opinion as concluding only that a receiver is not a typical employer under the NLRA insofar as his 8(d) duty to bargain is limited by his lack of legal authority to affirm an executory labor agreement without the permission of the bankruptcy court. *Cf. Truck Drivers Local 807* v. *Bohack Corp., supra,* 541 F.2d at 320 (observing that the statement that the debtor is not a "party" cannot be taken literally since one not a party technically cannot affirm or reject an agreement).

We now address the issue whether the district court was correct in concluding that the receiver lacked authority to bind the debtor's estate by affirming the contract. We begin with the basic principles that the "order authorizing the receiver to operate the business does not, in itself, confer unlimited authority to operate the . . . [h]otel," *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 786 (quoting 8 Collier on Bankruptcy ¶ 6.35[8], pp. 961-65 (14th ed. 1976)), and that "[p]arties dealing with a receiver are charged with knowledge of the extent of any restrictions upon his authority." *Id.* (citing *In re Yellow Transit Freight Lines,* 207 F.2d 602, 606 (7th Cir. 1953)). As the receiver's order of appointment by the bankruptcy court does not appear to grant any unusual authority, the question here is essentially one of law and not of construction of the appointing order.

While neither we nor the Supreme Court has passed on the question before us, the more persuasive cases from other jurisdictions hold that " 'assumption or adoption of the contract can only be effectuated through an express order of the [bankruptcy] judge.' " *In re American National Trust,* 426 F.2d 1059, 1064 (7th Cir. 1970) (quoting 6 Collier on Bankruptcy ¶ 3.23[5], p. 578 (14th ed. 1976)). *See also Texas Importing Co.* v. *Banco Popular de Puerto Rico,* 360

F.2d 582, 584 (5th Cir. 1966). The basic reasoning for this view is expressed by Collier:

> The general rule that economy of administration calls for close, strict, and active control by the court of all administrative expenditure seems to lead to the conclusion that it is improper for a trustee to assume executory contracts on his own responsibility.

4A Collier on Bankruptcy ¶ 70.43[5], at 531 (14th ed. 1976). Similarly, we have expressed the view that "[i]t is well settled bankruptcy law that on important decisions, whatever their character, the trustee must get the court's approval. . . ." *Newport* v. *Sampsell,* 233 F.2d 944, 946 (9th Cir.), *cert. denied,* 352 U.S. 942 (1956).

Indeed, as the bankruptcy court is vested with exclusive jurisdiction over the property of the debtor, we believe its authority to allow rejection of burdensome contracts gives it a needed flexibility that should not be relinquished except by the court. Therefore, we agree with the Fifth Circuit that the Act should not be construed to grant the trustee or receiver authority to "bar the court from exercising its statutory power to authorize the rejection of such a contract. . . ." *Texas Importing Co.* v. *Banco Popular de Puerto Rico, supra,* 360 F.2d at 584. This concern for needed flexibility is particularly compelling as against the Union's contention that the receiver should be viewed as having affirmed the contract when he knowingly conforms to its terms. *See Pacific Western Oil Co.* v. *McDuffie,* 69 F.2d 208, 213 (9th Cir.), *cert. denied,* 293 U.S. 568 (1934) (recognizing the receiver's need to be able to conform to the terms of an existing contract experimentally while deciding whether the contract should be rejected or affirmed).

It should come as no surprise that there is conflicting authority on this issue since the power to assume executory contracts is not found in the Act, but rather is inferred from the bankruptcy court's power to approve rejection

of such agreements. 8 Collier on Bankruptcy, ¶ 315[6], at 204-05 (14th ed. 1976). Some courts have recognized a receiver's right to affirm executory contracts, relying upon precedent from pre-Bankruptcy Act reorganization under equity, in which receivers had that authority. *E.g., In re Public Ledger, Inc.,* 161 F.2d 762 (3d Cir. 1947). This practice, in turn, has been criticized on the ground that the Bankruptcy Act is intended to involve "a higher degree of judicial supervision and responsibility." 4A Collier on Bankruptcy, ¶ 70.43, at 531-32 n.30b. We are in accord with the latter view and agree with the district court that "[t]he assumption or rejection of executory agreements affects the outcome of the chapter proceeding and should proceed under the supervision of the court." *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 787.

The Union relies primarily on *In re Public Ledger, Inc., supra,* 161 F.2d 762, which held that a receiver or trustee has authority to assume a labor agreement without seeking the approval of the bankruptcy court and may do so by knowingly conforming to its terms. *Id.* at 767. The case involved an employee's claim for vacation pay that had accrued under a collective bargaining agreement entered into prior to the outset of bankruptcy proceedings. Trustees had paid wages according to the terms of the agreement, but the bankruptcy court denied claims for vacation pay on the ground that it had never approved assumption of the agreement. The Third Circuit stated that "[i]t is unreasonable to assume that the [bankruptcy] court contemplated anything but the continuance of the labor contract as the basis for the continued services of the employees." *Id.* In addition, the court focused on the equities involved, observing that "the claimant had worked for a year and was entitled to his vacation pay." *Id.* at 768.

It appears to us, however, that the court in *Public Ledger* could have ruled on a narrower ground[4] and did

not adequately consider the implications of granting authority to a receiver or trustee to adopt a long-term collective bargaining agreement. We have not found any cases holding that a receiver or trustee had authority to adopt a long-term collective bargaining agreement that actually bound the debtor's estate beyond the term of his trust, and, like the district court, we find the reasoning against such authority "even more persuasive if the assumption of an executory contract will bind the estate in the future rather than merely establish a priority as an administrative expense." *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 788. Since the equities of cases such as *Public Ledger* can be addressed without granting receivers authority to bind the debtor and without removing needed supervision power and flexibility from the bankruptcy court, we conclude that the receiver lacked authority to adopt the 1973-1977 labor agreement.[5] Consequently, the bankruptcy court retained power to authorize rejection of the agreement.[6]

IV

We address, finally, whether the bankruptcy court could void the new agreement extending and modifying the pre-bankruptcy contract between Hotel Circle and the Union. This issue turns on whether the receiver was authorized to enter into a long-term collective bargaining agreement.[7] Courts do not recognize contracts that exceed the limited authority of a receiver, *In re Avorn Dress Co.,* 79 F.2d 337 (2d Cir. 1935), and parties dealing with a receiver are charged with knowledge of his limited authority. *Id.*; *In re Yellow Transit Freight Lines, supra,* 207 F.2d at 606. Courts generally will not retroactively validate contracts which exceeded the authority of the receiver. *In re Avorn Dress Co., supra,* 79 F.2d 337; *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 790 & n.2.

The Union contends, however, that the receiver possessed authority to enter into the new contract. It argues that we should read the language of the receiver's order of appointment together with the receiver's duty to bargain under the labor laws to find that he had such authority. The order of appointment authorizes the receiver to "enter into any contracts incidental and usual to the operation of said business and the management and preservation of said property." The Union contends that a labor agreement is "incidental and usual" to the operation of a hotel, and it argues that receivers will be unable to secure the labor needed to operate the business if they are unable to enter into such agreements. In most respects, their arguments here parallel those discussed earlier in which they contended that receivers may unilaterally assume existing agreements. We reject these arguments for basically the same reasons.

We first examine the language of the order of appointment. The Union emphasizes that long-term collective bargaining agreements are typical in the hotel industry, suggesting that this makes them "incidental and usual." We believe that the phrase "incidental and usual" has a more restrictive meaning, and that it refers to contracts necessary to the daily operation of the business. As stated by the Supreme Court:

> It is undoubtedly true that a receiver, without the previous sanction of the court . . . may incur ordinary expenses or liability for supplies, material, or labor needed in the daily administration of . . . property committed to his care as an officer of the court; but it seems equally well settled that the courts decline to sanction the exercise of this discretion on the part of receivers in respect to large outlays, or contracts extending beyond the receivership, and intended to be binding upon the trust.

Chicago Deposit Vault Co. v. *McNulta, supra,* 153 U.S. at 561. *Cf. Newport* v. *Sampsell, supra,* 233 F.2d at 946 (it is settled that the trustee must get the court's approval on all important decisions).

We are not persuaded that the relevant case law justifies a different result in the case of long-term collective bargaining agreements. The most illustrative example of a court sanctioning a receiver or debtor-in-possession entering into a labor agreement is *In re Wil-Low Cafeterias, Inc.,* 111 F.2d 429 (2d Cir. 1940). In that case, much as in *In re Public Ledger, Inc.,* discussed earlier, employees sought to obtain accrued vacation pay that had been denied by the trustee on grounds that the debtor's post-bankruptcy contract was invalid as beyond the authority granted the debtor-in-possession by the bankruptcy court. We agree with the district judge that the court in *Wil-Low* recognized the agreement "for the purpose of awarding benefits accrued under the contract," *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 786, and we would apply the same analysis developed in our discussion of *In re Public Ledger, Inc.* Indeed, *Wil-Low* appears to acknowledge the limitation we are recognizing as the court specifically reserved the question whether the debtor-in-possession could have bound the estate in the future without permission of the court: "It may be that the court would have had the power to rescind such a contract so far as it remained unperformed, but no such thing was attempted." *In re Wil-Low Cafeterias, Inc., supra,* 111 F.2d at 431.

We conclude, therefore, that the district court was correct in deciding that "[t]he order authorizing the receiver to continue to operate the business of the debtor, did not grant the receiver the authority to enter into . . . the modified collective bargaining agreement. . . ." *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp. at 791. This conclusion is unaffected by the re-

ceiver's status as an employer under the labor laws and his corresponding duty to bargain. The receiver is required to retain any grievance machinery to process employee disputes, and he is obligated to meet and confer with the employee bargaining representative as required by section 8(d). Nevertheless, his section 8(d) duties are limited to the extent that he cannot enter into a long-term collective bargaining agreement without obtaining the permission of the bankruptcy court.

It may at first glance seem harsh to allow the debtor relief from the contract entered into and relied upon by the Union. We have already observed, however, that parties dealing with an officer of the bankruptcy court are assumed to know the limits of his authority. In addition, it is not as though a union is without an option in such cases. Both with reference to adoption of an existing agreement as well as the negotiation of a new one, a union may insist upon obtaining the authorization of the bankruptcy court. *See Texas Importing Co.* v. *Banco Popular de Puerto Rico, supra,* 360 F.2d at 584-85; *Philadelphia Co.* v. *Dipple,* 312 U.S. 168, 174 (1941). Unions should be on notice that court approval is required if a long-term collective bargaining agreement, with potential for binding the estate beyond the term of receivership, is to be affirmed or validly entered into by the parties.

AFFIRMED.

FOOTNOTES

[1] The section provides:

> Upon the filing of a petition, the court may, . . .—
>
> (1) permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate.

[2] In *Kevin Steel,* the court also addressed the argument, not presented to us, that businesses will enter bankruptcy proceedings to free themselves of labor agreements. *Shopmen's Local 455* v. *Kevin Steel, Inc., supra,* 519 F.2d at 705-06. Our decision does not reach the issue but leaves room for a later determination whether, when the debtor is in bad faith, the agreement is therefore not onerous or burdensome. *See In re Mamie Conti Gowns, Inc.,* 12 F. Supp. 478, 480 (S.D.N.Y. 1935).

We also do not need to address the question whether the bankruptcy court should apply a stricter standard for authorizing the rejection of collective bargaining agreements as a means of reconciling the policies of the labor and bankruptcy laws. *Compare Shopmen's Local 455* v. *Kevin Steel Products, Inc., supra,* 519 F.2d at 706-07, *with Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc., supra,* 419 F. Supp., at 789.

[3] In some cases the bankruptcy court will not need to reach the rejection issue. For example, if an extension of an old contract or a new contract does not receive approval of the bankruptcy court, the new employer would not be bound by it, *e.g., NLRB* v. *Burns Int'l Security Services, Inc.,* 406 U.S. 272 (1972), and that might well be dispositive of the case. That determination would be based upon whether or not the remaining time of the old contract, here from 1975 to 1977, needs to be rejected in order to fulfill the purposes of the Bankruptcy Act. Under *Burns* and other cases, there may not be a need for the bankruptcy court to act any further as the new owner may be insulated under the successor employer doctrine. *E.g., id.* On the other hand, in some circumstances a new employer may have the responsibility to arbitrate over provisions in the old contract arguably intended to be given continuing effect. *See John Wiley & Sons, Inc.* v. *Livingston,* 376 U.S. 543, 552-55 (1964). Whether such concerns are present, and whether the bankruptcy court therefore reasonably believes that a rejection order is necessary as a concondition of the new employer purchasing the old company, must be determined on a case-by-case basis. Here we cannot say that the bankruptcy court was in error when it considered that there was a need to reject the remaining part of the whole contract.

[4] In *In re Schenectady Ry.,* 93 F. Supp. 67 (N.D.N.Y. 1950), for example, the court found that trustees in a Chapter X proceed-

ing were obligated to pay accrued pension benefits, but still concluded that the contract had not been assumed nor could be without court approval. Since the trustee's order of appointment authorized him to pay the operating expenses of the business, including wages, the court found that the trustee had adopted certain employee benefits, including pensions and vacation pay, as part of those wages when he used the labor contract "as a yardstick or measure of obligations" and knowingly conformed to the agreement's terms. *Id.* at 69. Although "equitable considerations" required that the pensions be paid as "a part of operating expense . . . during the period that the parties knowingly conform to the terms of the contract," *id.* at 70, the court still held that the trustee could not adopt the agreement because it "might seriously encumber the assets [of the debtor] without the consent and approval of the Court." *Id.* at 69. *See also In re Capital Service, Inc.*, 136 F. Supp. 430, 437 (S.D. Cal. 1955) (finding vacation pay to be an administration expense without reaching assumption question on ground that debtor "rehired the employees at the old rates of pay and under the old terms and conditions of employment"); 4A Collier on Bankruptcy ¶ 70.43[5], at 531 n.30b (14th ed. 1976).

[5] Thus, despite the Second Circuit's persuasive reasoning on the applicability of section 313(1) to labor agreements, we reject their additional conclusion that a receiver may assume an executory contract by conforming to its terms. *See Brotherhood of Railway, Airline and Steamship Clerks v. REA Express, Inc.*, 523 F.2d 164, 170 (2d Cir.), *cert. denied*, 423 U.S. 1017 (1975) (relying on *In re Public Ledger, Inc., supra*).

[6] Having concluded that the receiver lacked authority to affirm a long-term collective bargaining agreement, we need not address whether the district court erred in finding that the receiver did not manifest a clear intent to affirm the contract.

[7] Like the district court, we do not reach the question whether section 313(1), allowing rejection of executory contracts of "the debtor," applies to valid contracts of the receiver.

Nos. 79-1458 and 79-1459

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1979

MORGAN GUARANTY TRUST COMPANY OF NEW YORK, PETITIONER

v.

ALTON RINIER, AS AGENT FOR CERTAIN EMPLOYEES OF BANKRUPT, ET AL.

CHARLES G. RODMAN, AS TRUSTEE OF THE ESTATE OF W. T. GRANT COMPANY, BANKRUPT, PETITIONER

v.

ALTON RINIER, AS AGENT FOR CERTAIN EMPLOYEES OF BANKRUPT, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1979

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MORGAN GUARANTY TRUST COMPANY OF NEW YORK, PETITIONER

v.

ALTON RINIER, AS AGENT FOR CERTAIN EMPLOYEES OF BANKRUPT, ET AL.

No. 79-1459

CHARLES G. RODMAN, AS TRUSTEE OF THE ESTATE OF W. T. GRANT COMPANY, BANKRUPT, PETITIONER

v.

ALTON RINIER, AS AGENT FOR CERTAIN EMPLOYEES OF BANKRUPT, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE NATIONAL LABOR RELATIONS BOARD IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Jt. App. 4a-7a)[1] is not yet reported. The opinion of the district court (Jt. App. 9a-21a) is reported at 474 F. Supp. 788. The opinion and order of the bankruptcy judge (Jt. App. 23a-31a) are unreported.

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[1] "Jt. App." refers to the Joint Appendix filed by Morgan Guaranty Trust Company of New York ("Morgan"), petitioner in No. 79-1458, and by Charles G. Rodman, as Trustee of the Estate of W. T. Grant Company, Bankrupt ("Rodman"), petitioner in No. 79-1459. "App." refers to the appendix filed in the court of appeals. The court of appeals initially decided this case by order entered on the day of oral

JURISDICTION

The judgment of the court of appeals was entered on January 3, 1980. The petitions for a writ of certiorari were filed on March 18, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether claims resulting from the debtor-in-possession's unauthorized abrogation of the severance pay provisions of its collective agreements are entitled to priority as costs and expenses of the administration of a Chapter XI Bankruptcy Act estate.

2. Whether a debtor-in-possession may, without securing the approval of the bankruptcy court, abrogate the terms of a collective agreement negotiated between the debtor and the bargaining representative of its employees when the debtor [in] possession has taken the benefits of the agreement.

---

argument (Jt. App. 4a-7a). On motion of the National Labor Relations Board ("Board"), the court of appeals subsequently issued a written opinion, which is identical thereto except for the substitution of the following paragraph in lieu of the first two paragraphs at Jt. App. 5a:

PER CURIAM:

We affirmed by our memorandum order entered January 3, 1980 the judgment of the district court in this case. The National Labor Relations Board thereafter requested that we publish our decision. In accordance with our practice in appropriate cases of publishing previously unpublished decisions or orders of this Court, *Braunstein* v. *Eastern Photographic Laboratories, Inc.*, 600 F. 2d 335 (2d Cir.) (per curiam), *cert. denied*, 411 U.S. 944 (1979); *Continental Stock Transfer and Trust Co.* v. *SEC*, 566 F. 2d 373, 374 n. 1 (2d Cir. 1977) (per curiam), we now publish the following opinion in the instant case which incorporates in substance our memorandum order of January 3, 1980.

STATUTES INVOLVED

Section 64a of the Bankruptcy Act, 11 U.S.C. (1976 ed.) 104(a), is set forth in the petitions (Morgan Pet. 3-4; Rodman Pet. 3-4). Also relevant is Section 313(1) of the Bankruptcy Act, 11 U.S.C. (1976 ed.) 713(1), which provides:

> Upon the filing of a petition the court may * * *
>
> (1) permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate;

STATEMENT

1. W. T. Grant Company ("Grant") filed a Chapter XI reorganization petition on October 2, 1975. Thereafter, Grant operated as a debtor-in-possession until April 13, 1976, when the reorganization was superseded by a liquidating bankruptcy proceeding. When the Chapter XI petition was filed, Grant had approximately 75,000 employees, about 3,500 of whom were covered by 53 collective bargaining agreements, which provided for the payment of severance benefits to eligible employees in the event of involuntary termination.[2] Grant never sought permission of the bankruptcy court to reject any of these agreements pursuant to Section 313(1) of the Bankruptcy Act, 11 U.S.C. (1976 ed.) 713(1).

---

[2]The precise amount of the payment depends upon the employee's length of service and his weekly salary at the date of termination (Jt. App. 11a).

Early in the Chapter XI proceeding, Grant announced its unilateral decision to discontinue the payment of severance benefits.[3] During the administration of the Chapter XI proceeding, Grant terminated numerous employees in circumstances entitling them to severance pay under the collective bargaining agreements. Grant made no severance payments to these employees (Jt. App. 11a-12a, 23a-24a). The Board participated in the bankruptcy proceeding as a creditor. See *Nathanson* v. *NLRB*, 344 U.S. 25 (1952).

2. Petitioner Rodman, who was appointed trustee after Grant had been adjudged bankrupt, applied to the bankruptcy court for instructions concerning the disposition of former employees' severance pay claims.[4] The bankruptcy court held that severance pay claims of employees discharged during the aborted Chapter XI proceeding are entitled to priority as costs and expenses of that proceeding (Jt. App. 25a-29a). The district court and the court of appeals both affirmed (Jt. App. 9a-21a; 4a-7a).

---

[3]Grant erroneously indicated to its employees that the Bankruptcy Act prohibited such payments without court authorization, stating that "it is your Management's hope that this prohibition can be lifted at some time during 1976" (App. 293), and that the "Company is developing a plan for the payment of Termination or Incentive Pay, in connection with the store closings, but such plan will be subject to the approval of the Bankruptcy Court" (*id.* at 292).

[4]At most, $2 million are in controversy (see Morgan Pet. 7 n.*). That amount is approximately .3% of the $650 million claimed by petitioner Morgan and the other banks that it represents.

The court of appeals found that "Grant received benefits under [the collective bargaining] contracts by permitting the workers to continue in its employ after it entered Chapter XI" (Jt. App. 5a), and it held that Grant's "posting notices in its stores that it was discontinuing the severance pay benefits" (*ibid.*) was insufficient to reject its collective bargaining agreements because "only a formal rejection pursuant to § 313(1) of the Bankruptcy Act * * * is sufficient to disaffirm an executory contract" (Jt. App. 6a). The court also held "that the entire portion of the employees' severance pay claims is entitled to first priority as costs and expenses of administration" (*ibid.*).

ARGUMENT

1. In *Straus-Duparquet, Inc.* v. *Local Union No. 3 International Brotherhood of Electrical Workers*, 386 F. 2d 649, 651 (2d Cir. 1967), the Second Circuit held that collective bargaining agreement severance pay claims, based on employee discharges during a Chapter XI administration, are entitled to the first priority under Section 64a(1) of the Bankruptcy Act—as "costs and expenses of administration"—even though part of the employment period upon which the claims are based preceded the initiation of the reorganization proceeding. The court held that the discharge date is decisive because severance pay, unlike wages, "is not earned from day to day and does not 'accrue' so that a proportionate part is payable under any circumstances" (386 F. 2d at 651). In *In re Public Ledger*, 161 F. 2d 762, 773 (3d Cir. 1947), the Third Circuit had reached the opposite conclusion, holding that only that portion which accrued during the Chapter XI proceeding is entitled to priority if the amount of severance pay is conditioned upon the length

of an employee's service.[5] In *In re Mammoth Mart, Inc.*, 536 F. 2d 950, 953 (1st Cir. 1976), the First Circuit agreed with the Third Circuit.[6]

Petitioners urge (Morgan Pet. 2, 8-9, 13-17; Rodman Pet. 8, 18-20) that this Court should grant certiorari to resolve this conflict. We acknowledge the existence of this conflict, as did the court below (Jt. App. 6a-7a). We do not believe that certiorari is warranted, however, because this conflict no longer presents a question of general importance.

The Bankruptcy Code of 1978 ("the Code"), 11 U.S.C. App. (Supp. II) 101 *et seq.*, prospectively repeals the Bankruptcy Act and controls all bankruptcy proceedings that were filed on and after October 1, 1979. Section 507(a)(3) of the Code, 11 U.S.C. App. (Supp. II) 507(a)(3), expressly grants a third priority position to severance pay earned during the 90 days preceding the filing of the petition or the cessation of the business,

[5]However, the court held that severance pay which "moves to all employees regardless of length of service * * * [would] be wages wholly earned and accrued under the trustees' management and, therefore * * * entitled to priority." *In re Public Ledger, supra*, 161 F. 2d at 771.

[6]The claims in *Mammoth Mart* did not involve a collective bargaining agreement. Indeed, the First Circuit suggested that if employees were induced to remain on the job by the debtor-in-possession's representations that severance pay would be paid based on the prior practice, such pay might be entitled to a Section 64a(1) priority because "[t]hen the consideration supporting [the employees'] claims would be the services performed subsequent to the debtor-in-possession's promise." *In re Mammoth Mart, supra*, 536 F. 2d at 955 n.4.

whichever occurs first.[7] While this provision is not dispositive of how severance pay should be calculated where it is an expense of administration, the obligation having ripened during the Chapter XI period,[8] the congressional determination that severance pay should be treated as a form of wages provides a significantly changed statutory context for deciding this question under the new Code. In sum, determination of that issue under the old Act no longer presents a question of continuing importance, and this case presents no occasion for determining that issue under the new Code.

2. Petitioners also contend (Rodman Pet. 9, 16-17)[9] that certiorari should be granted to resolve a conflict between the Second and Ninth Circuits on whether a debtor's collective agreement obligations may be assumed

[7]Section 507(a)(3) of the Code provides:

> The following expenses and claims have priority in the following order: * * *
>
> (3) Third, allowed unsecured claims for wages, salaries, or commissions, including vacation, severance and sick leave pay—
>
> (A) earned by an individual within 90 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only
>
> (B) to the extent of $2,000 for each such individual.

This provision replaces Section 64a(2) of the Act, 11 U.S.C. (1976 ed.) 104(a)(2), which accorded a second priority to:

> wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding * * *

[8]Section 507(a)(1) of the Code, 11 U.S.C. App. (Supp. II) 507(a)(1), continues to afford first priority to expenses of administration.

[9]Morgan adopts Rodman's argument in this regard (Morgan Pet. 4 n.*).

by conduct or only when approved by the bankruptcy court. That alleged conflict does not require the granting of certiorari in this case, however, because both circuits agree that obligations under an agreement must be met if, as here, the debtor-in-possession or receiver has accepted the benefits of the agreement, regardless of the presence OR absence of bankruptcy court approval.

In *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc.*, 613 F. 2d 210 (9th Cir. 1980) (Jt. App. 33a-48a), the debtor-in-possession and receiver both operated under a collective agreement that had been negotiated by the debtor. The receiver renegotiated the agreement and paid the employees accordingly, but without seeking the bankruptcy court's approval. Thereafter, the receiver petitioned the bankruptcy court to allow him to reject the collective agreement and thereby facilitate the sale of the business (Jt. App. 33a-34a). The Ninth Circuit affirmed the decisions of the district court and the bankruptcy judge relieving the debtor from the collective agreement. Contrary to the Second Circuit's view, the Ninth Circuit held that a debtor-in-possession or receiver could not bind the debtor's estate to a collective agreement without the permission of the bankruptcy court (Jt. App. 40a-43a, 48a n.5). However, the Ninth Circuit indicated that it would require the debtor-in-possession or receiver to meet any obligations it had incurred under a collective agreement where, as here, he had taken the benefits thereof (Jt. App. 42a-43a). In sum, both the Ninth and Second Circuits agree that, in the circumstances presented here, the debtor-in-possession or receiver would have to meet any obligations incurred while operating under the collective

agreement, regardless of whether the bankruptcy court had previously approved the agreement.[10]

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1980

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[10]Even if a conflict existed, which it does not, that conflict would lack general importance in light of the adoption of the new Code. Whereas Section 313(1) of the Bankruptcy Act, 11 U.S.C. (1976 ed.) 713(1), speaks only of "rejection of executory contracts," Section 365(a) of the Code, 11 U.S.C. App. (Supp. II) 365(a), provides that "the trustee, subject to the court's approval, may *assume or reject* any executory contract * * *" (emphasis added). See also Section 365(d)(2) of the Code, 11 U.S.C. App. (Supp. II) 365(d)(2).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1458

No. 79-1459

CHARLES G. RODMAN, as Trustee of the Estate of W.T. GRANT COMPANY, Bankrupt and MORGAN GUARANTY TRUST COMPANY OF NEW YORK,

Petitioners,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt; ANSWERING EMPLOYEES OF BANKRUPT, LOCAL 807-IBT; RETAIL CLERKS INTERNATIONAL ASSOCIATION; and NATIONAL LABOR RELATIONS BOARD,

Respondents.

BRIEF OF RESPONDENT RETAIL CLERKS INTERNATIONAL ASSOCIATION IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

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Respondents.

BRIEF OF RESPONDENT RETAIL CLERKS INTERNATIONAL ASSOCIATION IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

Questions Presented

1. Whether the Second Circuit correctly decided that severance pay claims of employees terminated during the administration of the estate which, pursuant to a collective bargaining agreement, were calculated according to the total length of service to the bankrupt are to be paid in full as costs and expenses of administration.

2. Whether an executory collective bargaining agreement may be rejected by the Trustee without compliance with the provisions of Section 313(1) of the Bankruptcy Act.

Statutes Involved

In addition to the relevant statutory provisions cited in the petition, Section 313(1), 11 U.S.C. §713(1), omitted by Petitioners provides, in part, as follows:

> §713. Same; administration of estate
>
> Upon the filing of a petition, the court may, in addition to the jurisdiction, powers, and duties conferred and imposed upon it by this chapter—
>
> (1) permit the rejection of executory contracts of the debtor, upon notice of the parties to such contracts and to such other parties in interest as the court may designate; . . .

Statement of the Case

W.T. Grant (hereinafter "Grant"), was engaged in the business of operating a nationwide chain of retail outlets. On or about October 2, 1975, Grant filed a petition for an arrangement under Chapter XI of the Bankruptcy Act (hereafter "Act"), 11 U.S.C. §722. In accordance with an order dated April 13, 1976, Grant was adjudicated bankrupt.

Prior to the Chapter XI proceedings, Grant operated over 1,000 retail outlets. Some of its employees were covered by approximately 53 collective bargaining agreements with approximately 14 local unions affiliated with the Retail Clerks' International Association (hereinafter

"RCIA"). The great majority of employees, however, were not subject to collective bargaining agreements but rather, as non-union employees, were subject to the Grant's Store Manual, the New York Office Supervisor's Personnel Manual and the District Manager's Guide To Termination Policy And Procedure.

While the language contained in the 53 collective bargaining agreements may differ, the agreements provide for severance pay only upon termination of employment. Severance pay is not payable unless and until the employee is permanently terminated through no fault of his own, such as a layoff for lack of work or a store closing. Thus, if an employee quits, no severance pay is due. The various collective bargaining agreements provide for different severance pay benefits and different eligibility requirements. The amounts due employees are computed by specific formulae, generally predicated on length of continuous service with Grant. The severance pay benefits are not vested. Indeed, regardless of the years of service rendered, employees who quit or are terminated for cause have no right to severance pay.

At no time during the proceedings under the Bankruptcy Act did the debtor-in-possession or the Trustee make any application pursuant to Section 313(1) of the Act, to reject any of the executory collective bargaining agreements between Grant and the various RCIA locals. Nor was any attempt made to renegotiate any of the terms and conditions contained in those agreements. In fact, the Trustee agrees that those former employees who were terminated during the course of the Chapter XI proceedings as a result of permanent layoffs and store closings are entitled to severance pay. The RCIA contends that under the terms of the applicable agreements the Trustee is responsible for payment of severance pay benefits *in full* to covered employees.

The position of RCIA is that severance pay is not "earned", nor is it apportionable as the Trustee contends. As discussed below, severance pay has been defined and is payable as compensation for the termination of employment.

By application to the Bankruptcy Court dated May 10, 1977, the Trustee sought instructions as to the disposition of the claims for severance pay benefits. The Bankruptcy Court held that the "severance" pay claimed by each former employee of Grant who was terminated during the Chapter XI proceedings should be paid in full as costs and expenses of administration under Section 64a(1) of the Act.

On July 19, 1979, the District Court affirmed the order of the Bankruptcy Court. Judge Kevin T. Duffy held that severance pay benefits guaranteed under collective bargaining agreements are not to be construed as wages and are, therefore, not divisible. Absent a rejection of the executory collective bargaining agreements by the Trustee, these claims are entitled to a priority as costs and expenses of administration.

On January 3, 1980 the Court of Appeals unanimously affirmed the decision of the District Court. That Court held that the Trustee was bound by executory employment contracts permitting employees to continue in its employ after it entered Chapter XI since the Trustee never rejected those collective bargaining agreements pursuant to Section 313(1) of the Act. Consequently, the claims arising from these collective bargaining agreements, are entitled to priority as costs and expenses of administration. (Section 64a(1) of the Act.) The Court followed the well settled rule in the Second Circuit that severance pay benefits provided under a collective bargaining agreement are not to be construed as wages.

REASONS FOR DENYING THE PETITION

I.

There Is No Conflict Among the Courts of Appeals on the Issue of the Status of Severance Pay as an Administrative Expense Under the Bankruptcy Act of Sufficient Significance to Warrant This Court's Review of the Decision Below

Petitioners' assertion that a conflict among the Court of Appeals justifies review of the decision in this case is narrowed when stripped of extraneous obfuscatory arguments.

Although the First, Second and Third Circuits have followed similar approaches pertaining to matters in the administration of debtor's estates under the Bankruptcy Act, particularly in matters which pertain to the resolution of labor disputes during the administration of an estate, it cannot be denied that there exists a difference in approach confined to a narrow issue of law. These Circuits agree that persons employed during the administration of an estate do confer valuable services. Further, they agree that claims arising during the administration are entitled to payment in full as an expense of administration. The sole narrow issue that divides the Circuits is whether severance pay claims of employees terminated during the administration, calculated according to the total length of service with the bankrupt, are entitled to payment in full as costs and expenses of administration. *Compare In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1970) and *In re Public Ledger, Inc.*, 161 F.2d 762 (3d Cir. 1947) *with Straus-Duparquet, Inc.* v. *Local Union No. 3, I.B.E.W., AFL-CIO*, 386 F.2d 649 (2d Cir. 1967) and *In re Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977).

The Second Circuit in *Straus-Duparquet, supra,* held that employees terminated during the administration of the bankrupt's estate, are entitled to the full amount of severance pay as an expense of administration. The facts in *Straus-Duparquet, supra,* and those in the case at bar, are strikingly similar. In both cases, employees were covered by collective bargaining agreements which provided for severance pay. Employees of both companies were terminated subsequent to the filing of petitions under Chapter XI of the Act. The court in *Straus-Duparquet, supra,* relied solely upon the definition and nature of severance pay as a form of compensation for termination; only those employees terminated as the result of a limited event were eligible for this one time benefit. Unlike vacation pay, severance pay does not accrue and cannot be apportioned.

In an earlier decision, the Fifth Circuit, held that ". . . the right to the severance wages arose only in the happening of the contingency specified in the contract". *McCloskey* v. *Division of Labor Enforcement, Department of Industrial Relations, California,* 200 F.2d 402 (5th Cir. 1952). *See also In Re Elliot Wholesale Grocery Co.,* 98 F.Supp. 1017 (S.D. Cal. 1951) where the court stated:

> So the severance pay is not earned, as the Trustee argues, at the time the contract of employment is entered into but at the time the week's notice is due . . .
>
> 98 F. Supp. at 1019

Recently, in *In the Matter of Unishops, Inc., supra,* the Second Circuit reaffirmed its holding in *Straus-Duparquet, supra.* Refusing to classify "severance" pay as "wages", the court defined severance pay as it is, i.e., "as compensation for termination of employment." 553 F.2d at 305, 308 n.3. Severance pay is a cost and expense under §64a(1) when termination occurs during administration.

Similarly, the Sixth Circuit in *In re Ad Service Engraving Co.,* 338 F.2d 41 (6th Cir. 1964), refused to classify severance pay as "wages earned"; rather such benefits were deemed damages and entitled to be treated as a cost and expense of administration.

The Trustee relies exclusively on two cases, *Mammoth Mart, supra,* and *Public Ledger, supra,* claiming that severance pay benefits must be allocated in the same manner as wages under Section 64a of the Act. In each decision, the court relied upon the facts of the individual case in resolving the question of priority treatment of severance pay as an expense of administration.

In *Mammoth Mart,* 536 F.2d at 955, the court held that employees terminated during the corporate reorganization had already received severance benefits and were not entitled to further severance benefits. In a footnote, the court stated:

> Where, as here, the claims are based upon a contract which the debtor-in-possession has neither rejected nor expressly affirmed, it is not clear whether the amount of the priority will be determined by the contract price or by the reasonable value of the services that have been provided. . . . Given our holding today, we need not take a position on this question.

Mammoth Mart 536 F.2d at 954 n.3. In short, the First Circuit simply did not address the issue presented here regarding the rejection or assumption of a contract nor, in confining its decision to the facts of that case did the court reach the question of the method of computing the amount of severance pay as it arose in the instant case.

Although in *Public Ledger,* 161 F.2d at 771, the Third Circuit erroneously classified severance pay under one

collective bargaining agreement as wages and treated claims thereunder as any other wage claim, that court also held, that lump sum severance benefits under another collective bargaining agreement were costs and expenses of administration entitled to payment in full.

The petition does not raise significant differences in approach by the several circuits cited regarding the status of severance claims arising under collective bargaining agreements warranting the grant of certiorari.

II.

There Is No Conflict Among the Circuits as to the Rejection or Assumption of Executory Contracts

The Trustee's contention that certiorari should be granted to review the Second Circuit decision binding him to the collective bargaining agreement absent an express order of the bankruptcy court is wholly without merit. As the court below recognized, only formal rejection pursuant to §313(1) of the Bankruptcy Act, 11 U.S.C. §713(1) (1976), is sufficient to disaffirm an executory contract.

In the present case, neither the debtor-in-possession nor the Trustee petitioned the Court for permission to reject the collective bargaining agreements as required by Section 313(1) or the Bankruptcy Act.

Section 313(1) of the Bankruptcy Act provides that the Court may:

> . . . permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate . . . .

The Trustee would have the Court completely ignore not only the requirements of Section 313(1) but its very existence. He suggests that it is not necessary to formally reject Grant's collective bargaining agreements with the RCIA. Without any statutory basis or other authority, the Trustee insists that *in futuro*, it *may* determine such agreements shall be continued, modified or ignored.

Had a petition been made to reject the collective bargaining agreements pursuant to Section 313(1) of the Act the Trustee or debtor-in-possession would nevertheless have had to meet the recognized test for rejection: that the collective bargaining agreements were onerous and burdensome. *See, Brotherhood of Railway and Steamship Clerks, Freight Handlers and Station Employees, AFL-CIO* v. *REA Express, Inc.*, 523 F.2d 164 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017, 1073 (1975, 1976); *Shopmen's Local Union No. 455, Int'l. Ass'n. of Bridge, Structural and Ornamental Iron Workers, AFL-CIO* v. *Kevin Steel Products, Inc.*, 519 F.2d 698 (2d Cir. 1975); *Local Joint Executive Board, AFL-CIO* v. *Hotel Circle, Inc.*, 613 F.2d 210 (9th Cir. 1980); *Matter of Alan Wood Steel Co.*, 449 F.Supp. 165 (E.D. Pa. 1978) *appeal dismissed*, 595 F.2d 1211 (3d Cir. 1979).

The cases relied upon by the Trustee,* holding that assumption of an executory contract requires an express order, are distinguishable from this case for at least two reasons. First, those cases involved reorganizations arising under Chapter X of the Act, an entirely separate and different statutory scheme than that of Chapter XI. Sec-

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* *In re Gulfco Investment Corp.*, 520 F.3d 741 (10th Cir. 1975); *In re Maryvale Community Hospital, Inc.*, 456 F.2d 414 (9th Cir.), *cert. denied*, 409 U.S. 879 (1972); *In re American National Trust*, 426 F.2d 1059 (7th Cir. 1970); *Texas Importing Co.* v. *Banco Popular de Puerto Rico*, 360 F.2d 582 (5th Cir. 1966).

ond, in *Gulfco, Maryvale* and *American National Trust, supra,* the Trustees *had filed* a petition either to reject or assume the executory contracts during the period of reorganization. The decision in *Texas Importing Co., supra* which involved a dispute challenging an order approving a plan of reorganization of a lessee, was expressly limited to reorganizations under Chapter X of the Bankruptcy Act. The formal applications were then scrutinized by the bankruptcy court and decisions rendered thereon.

The Trustee's reliance upon the above cases begs the issue in this case: the status of executory collective bargaining agreements where the non-bankrupt party has fully performed, the Trustee has accepted performance and the benefits thereof and has never filed a petition to reject.

The Trustee also improperly relies upon the decision of the Ninth Circuit in *Hotel Circle, supra,* which required the Trustee to petition the bankruptcy court for an express order for either the assumption or the rejection of the executory collective bargaining agreement. In that case, the representatives of a receiver continued to employ workers under a collective bargaining agreement, voted to accept a proposed wage increase and extended the life of that agreement. Four months later, the receiver applied for an order authorizing the sale of the hotel and filed a motion seeking to reject the agreement. The bankruptcy court granted the application. The Ninth Circuit found that the debtor-in-possession could reject the collective bargaining agreement under the Second Circuit test established in *REA Express, supra,* and *Kevin Steel, supra.* Here, the Trustee seeks to avoid the formal rejection requirements of Section 313 including, the Second Circuit test for rejection, thereby disrupting the statutory scheme.

The Trustee's reliance on *Nathanson* v. *National Labor Relations Board,* 344 U.S. 25 (1952) to bolster its argument is misplaced. *Nathanson, supra,* teaches that no claimant should get more than that to which he is entitled. It does not answer the question of what severance pay benefit is due to claimants in this case, nor does it address the issue of conflict in decisions among the Circuits. In the instant case, equality of distribution requires that the severance benefit claims be allowed in the full amount due under the agreement.

The Bankruptcy Reform Act of 1978, 92 Stat. 2549, 11 U.S.C. 101 et seq., (1978) (hereinafter "Bankruptcy Code") has absolutely no application to this case; nowhere does the Second Circuit suggest that its decision implicates the Bankruptcy Code. To the contrary, the decision in this case focuses upon the construction of the Bankruptcy Act holding that, "only a formal rejection pursuant to §313(1) is sufficient to reject the executory collective bargaining agreement." [Jt.App. 6a] The Court below was concerned only with a claim as an expense of administration during a Chapter XI reorganization under the Bankruptcy Act and did not contemplate a hypothetical case arising under the Bankruptcy Code.

III.

The Opinion of the Second Circuit Gave Full Consideration to the Issues Presented and Decided Them Correctly

The Second Circuit applied well-established principles to undisputed facts and determined that Grant never rejected the executory contracts of its employees pursuant to the formal requirements of Section 313(1) of the Bankruptcy Act. Rather, Grant received substantial benefits under these contracts by permitting the workers to continue their employment in an effort to rejuvenate the failing enterprise.

The benefit received by Grant was retention of an experienced work force familiar with its stores, its stock, its customers and its procedures. Those employees chose to stay, in consideration of, among other things, continued employment in a successfully rehabilitated corporation. They did not abandon their employment and seek employment with employers offering a more promising future. Could Grant have had any reasonable expectation that it would survive if its rank and file employees quit, requiring the recruitment and training of a new work force? If that had occurred, it would certainly have sounded the death knell of Grant.

The Trustee claims that under the decisions of *Kevin Steel, supra,* and *REA, supra,* Grant, as debtor-in-possession, was a new juridical entity which did not assume the existing collective bargaining agreements and, therefore, was not bound to comply with its terms.

The Trustee's logic is faulty in several respects. First, his position is inconsistent with his admission that severance benefits under the collective bargaining agreements are due, but that computation should not be made as provided therein. Additionally, *Kevin Steel, supra,* does not insulate the Trustee, or debtor-in-possession, from the duty to bargain imposed by Section 8(d) of the Labor Management Relations Act, as amended, 29 U.S.C. §158(d). Here, neither the debtor-in-possession nor the Trustee initiated or engaged in any collective bargaining negotiations with the RCIA regarding any changes in the terms and conditions of employment, including severance pay benefits.

Moreover, in *Kevin Steel, supra,* and *REA, supra,* the debtor-in-possession and the Trustee, respectively, followed the statutory requirements of Section 313(1) of the Act in an effort to reject the collective bargaining agreements. Significantly, on remand, District Judge Wyatt, in *REA,* 75 B 253 (1976), approved rejection of the collective bargaining agreement with one union, finding it onerous and burdensome; however, he did not approve the rejection of the collective bargaining agreement with another union, even though the debtor was a "new juridical entity."

Similarly inapposite is *In re Godwin Bevers Co., Inc.,* 575 F.2d 805 (9th Cir. 1978), cited by the Trustee for the proposition that claims which have matured prior to the bankruptcy proceedings are provable against the estate. In *Godwin, supra,* the court concluded that the agreement with the claimant was not executory; all that remained to be performed was for the bankrupt to be paid. In the instant case, the Trustee erroneously contends that severance pay should be apportioned over the several time periods under the Act which relate to the employees' service to the bankrupt. Hence any service performed prior to the Chapter XI proceeding should be treated either as a priority claim

under Section 64a(2) or as a general unsecured claim. If that were the case, an employee who quit after the filing of the petition under the Act should be entitled to prove a portion of a severance pay claim for his service prior to such filing. That result would be inconsistent with the concept of severance pay, since the "contingency" about which the Trustee is concerned has not occurred, i.e., an involuntary loss of employment.

Indisputably, the severance pay claims due under the RCIA collective bargaining agreements are "earned" only when employees are permanently and involuntarily terminated or laid off; they simply do not accrue. Therefore, employees terminated or laid off during the period of administration are entitled to have their claims treated as administration expenses and paid in full in amounts computed in accordance with the applicable agreements.

IV.

The Issue Submitted by the Petitioner Concerning Section 70(b) of the Bankruptcy Act Is Not Applicable

Section 70(b) of the Bankruptcy Act, 11 U.S.C., §110(b), which provides for the automatic rejection of executory contracts not otherwise acted upon by the Trustee within sixty days does not apply in this case. The definition of "executory contract" in the context of this section excludes a contract to which the non-bankrupt party has fully rendered his performance, and the bankrupt party has performed partially or not at all. *Jenson* v. *Continental Financial Corp.*, 591 F.2d 477 (8th Cir. 1979); *In the Matter of Chicago, Rock Island and Pacific Railroad Company*, 604 F.2d 1002 (7th Cir. 1979); *Northwest Airlines, Inc.* v. *Klinger*, 563 F.2d 916 (8th Cir. 1977); 4A Collier on Bankruptcy Section 70.43(2) at 522 (14th ed. 1976). In this case, the employees of Grant fully performed their obligations under the collective bargaining agreement. They were employed until permanently terminated during the period of administration while the Trustee attempted to rejuvenate the enterprise. It would be absurd to suggest that the contract was automatically rejected as of the filing date of the petition in bankruptcy. Such a conclusion would render Section 313 superfluous.

Having failed to make an application to reject, and having accepted the services of employees and received the benefits of their continued employment, the Trustee should not be heard to argue that the contract was never assumed.

CONCLUSION

The Second Circuit Court of Appeals correctly determined that the debtor was bound by the executory collective bargaining agreement since it received benefits thereunder and never petitioned for a formal rejection pursuant to Section 313(1) of the Act. Valid reasons exist for a denial of the writ of certiorari. There is no conflict among the Circuits as to the rejection and assumption of executory contracts. There is no substantial issue presented as to the priority status of a severance pay claim as ar administrative expense. For the foregoing reasons, it is respectfully submitted that the petition for certiorari should be denied.

Dated: New York, New York
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1458
No. 79-1459

CHARLES G. RODMAN, as Trustee of the Estate of W. T. Grant Company, Bankrupt, and MORGAN GUARANTY TRUST COMPANY OF NEW YORK,

Petitioners,

—v.—

ALTON RINIER, as Agent for Certain Employees of Bankrupt; Answering Employees of Bankrupt; Local 807-IBT; Retail Clerks International Association; and National Labor Relations Board,

Respondents.

BRIEF OF RESPONDENT ALTON RINIER, AS AGENT FOR CERTAIN EMPLOYEES OF BANKRUPT, IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

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BRIEF OF RESPONDENT ALTON RINIER, AS AGENT FOR CERTAIN EMPLOYEES OF BANKRUPT, IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

QUESTION PRESENTED

Are employees with contractual rights to severance benefits upon dismissal entitled to receive full severance benefits payable as a first-priority Chapter XI expense of administration where the employees are discharged during the Chapter XI proceeding after rendering beneficial services to the Chapter XI

debtor-in-possession and where there is no formal rejection of the severance contracts during the Chapter XI proceeding?

STATEMENT OF THE CASE

This brief is submitted on behalf of Alton L. Rinier, as common agent for a number of non-union employees of W. T. Grant Company ("Grant") in or about Ohio who were dismissed during the superseded Chapter XI proceeding in this case which lasted from October 2, 1975 to April 13, 1976. The legal issues involved in this case affect all former employees of Grant similarly situated and not represented by counsel.

The relevant facts are generally set forth in the opinions of the lower courts.* However, clarification is necessary in light of some of the contentions in the petitions for a writ of certiorari to the United States Court of Appeals for the Second Circuit of Charles G. Rodman, as Trustee of the Estate of Grant, Bankrupt (the "Trustee") and Morgan Guaranty Trust Company of New York, acting for itself and twenty-five (25) other banks ("Morgan Guaranty").

Prior to the commencement of the Chapter XI case, to induce persons to accept employment, Grant offered to potential employees a compensation package which included the payment of severance benefits, the amount dependent upon length of service and certain other conditions. Severance pay is due and payable only upon termination of employment for both union and non-union employees.

In accordance with the policies and procedures adopted by Grant and the applicable provisions of the collective bargaining agreements, as an employee's period of employment increased, the amount of his potential severance benefits for involuntary termination also increased. Nevertheless, the earning and vesting of severance benefits took place only upon the occurrence of an event: the involuntary dismissal of an employee.

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* See Petitioners' Joint Appendix I-III.

The pre-Chapter XI policies and procedures of Grant as to severance benefits, constituting executory contracts, intentionally were not rejected by Grant in its capacity as a debtor-in-possession pursuant to Section 313(1) of the Bankruptcy Act (the "Act"), 11 U.S.C. § 713(1), and Rule 11-53 of the Rules of Bankruptcy Procedure.

Subsequent to the filing of the Chapter XI petition, the debtor-in-possession apprised its employees and gave notice to all store managers that consideration of payments of severance benefits to discharged or terminated employees would be deferred because of the pendency of the Chapter XI case, and that no such benefits would be paid pending the development of a plan therefor and the approval thereof by the Bankruptcy Court. Without apparent authority and after many employees had been let go, the bankrupt's management on January 5, 1976 erroneously advised store managers that the Bankruptcy Court had ordered that the Company was "prohibited" from paying vacation and severance pay, adding its "hope" that such payments would be made in 1976.

The record is unclear, however, as to whether the first notice was given before or after January 1, 1976. Thus, during the early phases of the debtor-in-possession's retail store contraction and liquidation program, the employees were not alerted that the pre-Chapter XI policies, procedures and agreements as to severance benefits might be considered ineffective and might not be adopted by the debtor-in-possession.

On the contrary, the debtor-in-possession filed an application, dated April 8, 1976, for authorization to make payments to terminated employees of vacation and severance benefits as expenses of administration of the Chapter XI case, in accordance with Section 64a(1) of the Act, 11 U.S.C. § 104a(1), *Straus-Duparquet, Inc. v. Local Union No. 3, IBEW*, 386 F.2d 649 (2d Cir. 1967) and the Bankruptcy Court's decision affirmed in *In re Unishops, Inc.*, 553 F.2d 305 (2d Cir. 1977).

On October 28, 1975, Grant obtained an order authorizing it to pay severance benefits to John Sundman, a former Grant

senior executive, pursuant to a pre-petition agreement. The severance benefits were measured by six (6) months' salary.

In none of the decisions below did the Bankruptcy Judge, the District Judge or the Circuit Court Judges find that there was an express assumption by Grant of the severance benefits. Nevertheless, the Petitioner-Trustee seeks to characterize the liability of the debtor-in-possession as grounded in the assumption of the severance benefit agreements. *

Ironically, the Trustee proclaims his intention to "avoid inequity and prejudice to long-term creditors" ** as the reason for pressing in four (4) federal courts to reduce the severance benefits by millions of dollars. Petitioner Morgan Guaranty applauds the Trustee's position as "generous." ***

What is unclear from the petitions, however, is the background fact that in 1978 a limited fund was established for pro-rata payment of all unsecured debts of the estate other than the debts to the bank creditors represented by Morgan Guaranty, which group agreed to establish a much larger fund for the satisfaction of its debts. The practical effect of the decisions below was to permit payment of severance benefits from the bank group fund in the amount of approximately $11,384,000. If the Trustee and the bank group prevail in this case, the bank creditors will reduce this payment by approximately $2,000,000 and general creditors will receive less on their claims.

REASONS FOR DENYING THE WRIT

The Second Circuit considered two dispositive issues on appeal: (1) whether Grant, as debtor-in-possession, rejected the executory contracts of its employees; and (2) whether the sever-

* Trustee's petition at 7-8, 11-15.

** Trustee's petition at 7.

*** Morgan Guaranty's petition at 6.

ance pay claims arising from the Grant employment agreements are entitled to first priority as costs and expenses of administration. By answering the first question in the affirmative and the second in the negative, the Second Circuit followed the precedent it had set in *Straus-Duparquet, supra,* and *Unishops, supra.*

Although the petitions for a writ of certiorari allege that the Second Circuit decision is in direct conflict with the position taken by other circuit courts on each issue, each case cited by petitioners is distinguishable from this case on important legal and factual grounds. Thus, the Second Circuit decision does not stand in conflict with other circuits. In addition, the decision below is consistent with the Bankruptcy Act's terms and its fundamental purpose to apply assets equitably. Accordingly, the writ applied for herein should not be granted.

I

THE DETERMINATION THAT THE DEBTOR-IN-POSSESSION IS BOUND BY THE SEVERANCE AGREEMENTS DOES NOT CREATE A CONFLICT WITH THE DECISIONS OF OTHER COURTS OF APPEALS

The Second Circuit, citing *Unishops*, *supra*, found that Grant, as a Chapter XI debtor-in-possession, was bound by its employee severance pay agreements since it received benefits thereunder and it did not expressly reject the agreements pursuant to § 313(1) of the Act.*

No decision in any other circuit is directly in conflict with this holding. In *Local Joint Executive Board, AFL-CIO v. Hotel Circle, Inc.*, 613 F.2d 210 (9th Cir. 1980), cited extensively in the Trustee's petition for its alleged conflict with the Second Circuit's holding herein, the Court of Appeals for the Ninth

* Petitioners' Joint Appendix I.

Circuit expressly limited its holding so as not to impinge on the issues raised in the *Grant* case.

In the *Hotel Circle* case, the receiver negotiated a proposed sale of a hotel conditioned on the purchaser taking title clear of any existing collective bargaining agreement. Despite the receiver's prior acceptance without court approval of the collective bargaining agreement in question, the Ninth Circuit sanctioned the rejection of the collective bargaining agreement, holding the receiver lacked the power to preclude court action to reject an executory contract. When faced with the apparent conflict with the Third Circuit's holding in *In re Public Ledger, Inc.*, 161 F.2d 762 (3d Cir. 1947), which stated that a receiver or trustee has authority to assume a labor agreement without seeking court approval, the Ninth Circuit expressly narrowed its holding to the case's particular facts, stating:

> We have not found any cases holding that a receiver or trustee had authority to adopt a *long-term collective bargaining agreement that actually bound the debtor's estate beyond the term of his trust*, and, like the district court, we find the reasoning against such authority *"even more persuasive if the assumption of an executory contract will bind the estate in the future rather than merely establish a priority as an administrative expense." Local Joint Executive Board, AFL-CIO v. Hotel Circle, Inc., supra*, 419 F. Supp. at 788.

613 F.2d at 217 (emphasis added).

Thus, *Hotel Circle* and *Grant* are compatible, not in conflict. The adjudication in bankruptcy and consequent discontinuation of operations (including dismissal of all store employees) removes the *Grant* facts from the purview of *Hotel Circle*. The Grant debtor-in-possession never expressly assumed the severance agreements, as no court authorization was obtained. But the debtor-in-possession did receive benefits from the employees during the Chapter XI case, and it was prepared to acknowledge its obligation for severance pay. Recognition of the executory severance agreements in the *Grant* case serves merely to

establish a priority of the severance claims as an administrative expense.

The Trustee-Petitioner cites four other cases to support his allegations of conflict among the circuits as to the rejection or assumption of executory contracts without prior court approval, *In re Gulfco Investment Corp.*, 520 F.2d 741 (10th Cir. 1975), *In re Maryvale Community Hospital, Inc.*, 456 F.2d 414 (9th Cir. 1972), *cert. denied*, 409 U.S. 879 (1972), *In re American National Trust*, 426 F.2d 1059 (7th Cir. 1970), and *Texas Importing Co. v. Banco Popular de Puerto Rico*, 360 F.2d 582 (5th Cir. 1966).

However, the Trustee's citations are misleading, since he has misstated the issue herein as involving the rejection or assumption of executory contracts by a trustee. None of the *Grant* courts below found that the debtor-in-possession assumed the severance pay agreements. Rather, they found that the debtor-in-possession received substantial benefits from employees at a time when the severance executory contracts were still in effect.

Assuming, *arguendo*, that the *Grant* opinions below could be construed to have held that the debtor-in-possession assumed the severance pay agreements, a cursory examination of the Trustee's cases reveals the illusory nature of these alleged conflicts. Each case is a corporate reorganization under Chapter X of the Act, 11 U.S.C. § 501 et seq. The petition in the *Grant* case was originally filed under Chapter XI of the Act, 11 U.S.C. § 701 et seq. This difference itself renders the holdings of the cited Chapter X cases irrelevant to the severance pay issues in the *Grant* proceeding.

Chapters X and XI of the Bankruptcy Act were specifically devised to afford two different, legally mutually-exclusive procedural paths to financial rehabilitation. *SEC v. American Trailer Rentals Co.*, 379 U.S. 594 (1965). A major procedural distinction between the two Chapters is the requirement of the appointment of a disinterested trustee in Chapter X rather than the authorization of the debtor to continue in possession of its property in Chapter XI. *Compare* Section 156, 11 U.S.C. § 556,

with Section 342, 11 U.S.C. § 742. The appointment of a disinterested trustee in Chapter X proceedings implements congressional intent to "afford greater protection to creditors and stockholders by providing *greater judicial control over the entire proceedings* . . . ." *SEC v. American Trailer, supra* at 604 (emphasis added). *See Banco Popular, supra* at 584. Hence, any determination in a Chapter X proceeding concerning the power of the trustee to reject or assume executory contracts without the express authorization of the court is of little relevance to an analogous situation in a Chapter XI proceeding, in light of the recognized need for "greater judicial control" over a Chapter X proceeding.

Other significant legal and factual distinctions preclude the application of the cited Chapter X cases to the issue at hand. In neither *Gulfco* nor *Maryvale* was there a scintilla of language or implication supporting the Trustee's characterization of the holding of these cases, *i.e.*, "the assumption of executory contracts which results in the creation of first priority costs and expenses of administration . . . requires an express order of the Bankruptcy Court."* *Gulfco* holds merely that the trustee may have a reasonable time to determine whether to assume or reject an executory contract. The *Gulfco* court does not offer an opinion as to what happens when a contract is itself substantially performed by one of the contracting parties and the other already has received the fruits of the performance. *Maryvale* states simply that the power to *reject* the debtor's executory contracts lies solely in the Bankruptcy Court, not in the receiver or trustee. *Maryvale* is fully consonant with the respondent's view that in a Chapter XI proceeding, the debtor-in-possession cannot reject the labor agreements in question without the express authority of the Bankruptcy Court. *Maryvale* does not purport to preclude the debtor-in-possession from receiving benefits under an executory contract of the debtor and correspondingly becoming liable for obligations thereunder.

Another factual distinction serves to remove the instant case from the scope of the four cases cited by the Trustee. In each

* Trustee's petition at 9.

case a party to the executory contract sought to *prevent* the court from *expresssly rejecting* the executory contract, alleging that the court was estopped from so doing by prior acts of the trustee. On the other hand, the Grant Trustee seeks retroactively to deny the debtor-in-possession's intentions and actions respecting the severance agreements where *no application was made to the Court for explicit rejection of the executory contracts.**

Therefore, these cases may be reconciled by incorporating this distinction into the holdings, to wit: a trustee or receiver may not by his behavior preclude the Bankruptcy Court from *expressly* rejecting or assuming an executory contract. This allows the Bankruptcy Court to expressly reject an executory contract despite prior actions by the trustee in conformance with the contract, yet provides that the bankrupt estate may remain responsible for an executory contract where no action is taken by the Court to expressly reject the contract and the bankruptcy fiduciary has received benefits thereunder. This holding is consonant with all cases cited by the Trustee, the *Grant* case, and the statutory language of Section 313(1) of the Act.

II

THE CLASSIFICATION OF SEVERANCE PAY AS AN ADMINISTRATION EXPENSE DOES NOT CREATE A CONFLICT WITH THE DECISIONS OF OTHER COURTS OF APPEALS

In the second issue before the Second Circuit, the Court reaffirmed its decision in *Straus-Duparquet, supra*, holding that severance pay is compensation for termination of employment, not earned from day to day and, unlike wages, does not accrue. Therefore, severance pay owed to those employees whose jobs were terminated during the Chapter XI proceeding is entitled to

* In fact, application to pay employees under the severance agreements was made by the debtor-in-possession to the Bankruptcy Court on April 8, 1976 and was pending at the time of the adjudication in bankruptcy.

first priority as a cost and expense of administration pursuant to Section 64a(1) of the Act.

No case exists in any circuit in direct conflict with this holding. The factual circumstances of *In re Mammoth Mart, Inc.*, 536 F.2d 950 (1st Cir. 1976), cited by the Trustee-Petitioner as having been rejected by the Second Circuit's decision herein, differ significantly from those in the case at bar. When the narrow holding in *Mammoth Mart* is separated from the expansive dicta of the First Circuit therein, the result is that there is no genuine conflict between the holdings of the First Circuit in *Mammoth Mart* and the Second Circuit in *Grant*.

The First Circuit in *Mammoth Mart* said that

> whether a claim for severance pay based upon an unrejected contract with the debtor and arising from a chapter XI discharge will be entitled to § 64(a)(1) priority will depend upon the extent to which the consideration supporting the claim was supplied during the reorganization.

536 F.2d at 955. The Court then proceeded to analyze whether consideration was supplied during the reorganization.

Central to the First Circuit's reasoning is the threshold issue of the mere *existence* of some consideration furnished during the reorganization to support the first-priority severance pay claim. As the First Circuit found that the debtor-in-possession discharged the employees in question pursuant to an order entered only eleven (11) days after the filing of the Chapter XI petition and the employees already had received four (4) weeks' severance pay as an expense of administration, it concluded that no consideration was supplied to the debtor-in-possession. In this connection, *Mammoth Mart* is totally consistent with *Unishops* and *Grant*, in which cases it was found, contrary to *Mammoth Mart*, that the debtor-in-possession had received significant benefits from the parties claiming severance payments. Any further discussion of the First Circuit as to the mechanics of computing severance pay where such consideration is supplied is dicta, *i.e.*, unnecessary to the court's decision and therefore not binding authority. *See, e.g., Kastigar v. U.S.*, 406 U.S. 441 (1972). Such dicta should not serve as the foundation for a conflict among the circuit courts sufficient to support the petitions for a writ of certiorari in this matter.

Public Ledger, *supra*, the only other circuit court case cited by the Trustee for an alleged conflict with the case at bar on the priority claim issue, is distinguishable from the instant matter on several grounds.*

Public Ledger was a Chapter X proceeding under the Act, unlike the instant Chapter XI proceeding. A basic principle of bankruptcy jurisprudence is that the Act shall be construed in light of congressional intent. *See, e.g., Reading Company v. Brown*, 391 U.S. 471 (1968). Further, it is undisputed that Chapters X and XI were enacted to serve two separate and distinct purposes within the framework of corporate rehabilitation. *See, e.g., SEC v. American Trailer*, *supra*; *In re Peoples Loan & Inv. Co.*, 410 F.2d 851 (8th Cir. 1969). Despite the fact that Section 64a(1) applies to bankruptcy proceedings under both Chapters X and XI by virtue of Sections 102 and 302 of the Act, 11 U.S.C. §§ 502 and 702, Section 64a(1) must be construed to implement the distinct congressional intent of each chapter in which it is applied. Thus, the Third Circuit's construction of "expenses of administration" in the Chapter X proceeding of *Public Ledger* cannot be said to conflict with the different construction rendered by the Second Circuit in the Chapter XI proceeding herein.

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* In fact, in a case with issues virtually identical to the case at bar, on May 3, 1976 the Supreme Court denied certiorari to the Second Circuit in *In re The Bohack Corp.*, 535 F.2d 1240 (2d Cir. 1975), *cert. denied*, 425 U.S. 966 (1976), *rehearing denied*, 429 U.S. 875 (1976), despite the then petitioner's claim of an alleged conflict with *Public Ledger*, *supra* and the Bankruptcy Court's decision in *In re Mammoth Mart, Inc.*, 1 Bankr. Ct. Dec. 909 (D. Mass. 1975). After *Mammoth Mart* was affirmed by the First Circuit on June 18, 1976, the Bohack debtor and the creditors' committee submitted a motion for leave to file and petition for rehearing of order denying certiorari, which motion and petition emphasized the alleged conflict between the First and Second Circuits in *Mammoth Mart* and *Straus-Duparquet*, respectively. The Supreme Court denied the motion and petition on October 4, 1976 at 429 U.S. 875 (1976).

More importantly the § 64a(1) which the Third Circuit in *Public Ledger* construed in 1947 is not the same statute construed by the Second Circuit herein. Section 64a(1) has been amended several times since 1947. Respondent submits that the 1952 and 1967 amendments of § 64a(1) are of such legal significance that any construction of § 64a(1) prior to 1952 is of dubious precedential value and cannot be the basis of a conflict among the circuits.

The legal effect of the 1952 and 1967 amendments was to create a super-priority for expenses of administration incurred in an ensuing bankruptcy proceeding over unpaid expenses of administration incurred in a superseded reorganization proceeding. *Public Ledger* was a Chapter VII bankruptcy which superseded an unsuccessful Chapter X proceeding. The considerations of the Third Circuit in *Public Ledger* differed from those of the Second Circuit herein, given the Third Circuit's knowledge that any expenses of administration of the superseded Chapter X proceeding would be shared *pari passu* with the expenses of the ongoing Chapter VII proceeding.* It is evident that the Third Circuit's construction of § 64a(1) in 1947 cannot conflict with the Second Circuit's construction of a different statute thirty-three years later.

III

THE DECISION BELOW IS CONSISTENT WITH THE BANKRUPTCY ACT'S TERMS AND ITS FUNDAMENTAL PURPOSE TO APPLY ASSETS EQUITABLY

The characterization of severance benefits as priority claims, payable as costs and expenses of administration, is in accordance with the express standards of the Bankruptcy Act and the

* *See* S. Rep. No. 1395, 82d Cong., 2d Sess. 4 (1952), which provides as an explanation for the 1952 amendment to Section 64a(1) the concern that "[u]nless provision is made for payment of the costs and expenses necessary to liquidate, administer and close the estate in the ensuing bankruptcy proceeding, ahead of the prior incurred and unpaid administration costs and expenses, there is always danger of a breakdown of administration."

Act's fundamental purpose to apply assets equitably. Section 64a(1) provides that first priority be given to "the costs and expenses of administration . . . ." The determination of whether a particular claim is a cost or expense of administration is properly left for judicial interpretation by virtue of the vicissitudes and complexities of bankruptcy case administrations.

The Second Circuit in *Straus-Duparquet* determined that severance pay is

> a form of compensation for the termination of the employment relation . . . primarily to alleviate the consequent need for economic readjustment but also to recompense [the employee] for certain losses attributable to the dismissal.

386 F.2d at 651. By this self-evident determination the Second Circuit in *Grant* has accorded priority status to one hundred (100%) percent of the severance benefits pursuant to the express terms of Section 64a(1).

Petitioner Morgan Guaranty, in attempting to challenge the meaning given by the courts to § 64a(1), misconstrues the scope of "costs and expenses of administration." Petitioner Morgan Guaranty cites *Pomper v. U. S.*, 196 F.2d 211 (2d Cir. 1952), which held that federal unemployment taxes based on wage payments paid to the federal government at the end of the calendar year are generally accorded first-priority treatment only to the extent that the underlying wages are for post-filing services. Petitioner Morgan Guaranty then states that there is no reason to treat severance pay any differently.

Taxes accrue on a day-to-day basis. In the area of withholding taxes, the Internal Revenue Service has a direct interest, however, in the taxes as they accrue even in advance of the payment date. No action by the employer can preclude its payment upon the mere passage of time. *See* Int. Rev. Code of 1954, § 7501, 26 U.S.C. § 7501.

On the other hand, severance benefits do not accrue and claims therefor are not so neatly capable of measurement as accrued taxes. *Straus-Duparquet*, *supra*. The employee has no right to any payments until the termination of his employment, an act solely within the discretion of the employer. Even upon termination of employment, circumstances may exist which preclude the payment of severance benefits, *e.g.*, voluntary termination or termination for cause.

The Ninth Circuit in *Pomper* explained:

> The employer's tax at any given time in the taxable period can be accurately computed . . . . The mere fact that the tax is not due until the year's end does not detract from the fact that it is incurred in a readily ascertainable amount as the wages are paid out. *Indeed, if the employer sells out his business to a new employer at any point in the year, he will still be responsible for the tax of 3% on all wages paid out by him before the sale* . . . .

196 F.2d at 213 (emphasis added).

The allocation in *Pomper* is comparable to allocation of accrued vacation pay benefits. In *Straus-Duparquet* the Court held vacation pay benefits also will accrue and may be computed in a manner similar to tax payments in *Pomper*. But the Second Circuit in *Straus-Duparquet* observed that severance pay is different from vacation pay, which is part of an employee's compensation for services rendered. Rather, severance pay is compensation for termination of employment.

On the other hand, the District Court in *Grant* found that "the severance agreements were in no sense intended to be compensation for services rendered or to be rendered by Grant employees."* Also, the Bankruptcy Court below found that the Grant compensation package included "the *prospect* of receiving severance pay benefits in the event of dismissal . . . ." Until such dismissal an employee had only "*potential* severance pay benefits." (Emphasis added).**

* Petitioners' Joint Appendix II at 15a.

** Petitioners' Joint Appendix III at 23a.

Thus, severance benefits accrue one hundred (100%) percent upon termination and are entitled to priority as an administrative expense.

Assuming *arguendo* the correctness of Petitioner Morgan Guaranty's contention that severance benefits accrue partially prior to the filing of a petition in bankruptcy, this does not necessarily mandate a different result as to priority.

Bankruptcy proceedings themselves are equitable in their character and are to be administered in accordance with the general principles and practices of equity. *See*, *e.g.*, *Pepper v. Litton*, 308 U.S. 295 (1939); *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934). In the exercise of its equitable powers, the court may award priority status for severance benefits to reflect benefits conferred upon a debtor's estate. *See American Anthracite & Bituminous Coal Corp. v. Leonardo Arrivabene, S.A.*, 280 F.2d 119 (2d Cir. 1960); *Unishops*, *supra*.

The District Court herein found that

> had Grant been forced to terminate all its employees upon entering Chapter XI and thereafter recruit a new work force even its short-lived Chapter XI attempt would have been virtually impossible. Accordingly, in light of these benefits the severance claims of the employees were entitled to a priority as a cost and expense of administration. *Unishops*, *supra*, 553 F.2d 308.*

The award by the courts below of priority status to one hundred (100%) percent of severance pay was in recognition of the important benefits rendered Grant in their efforts to rehabilitate an ailing debtor. Had the Trustee attempted to assess the benefits conferred upon the debtor estate by the "reasonable value" standard under *American Anthracite*, *supra*, he may have found value in excess of the severance pay provisions delineated in the Grant Store Manual.

Petitioner Morgan Guaranty further argues that when applying its equitable discretion, the Court should consider the "possible crippling burden" of the Second Circuit's decision on a

* Petitioners' Joint Appendix III at 17a.

company needing the protection of the bankruptcy court. The Supreme Court has determined, however, that the burden of the Chapter XI operation of a debtor-in-possession upon innocent parties is of equal importance and may require the equitable award of priority claims even in excess of the assets of the debtor. *See Reading Company v. Brown, supra.*

Despite the Supreme Court's sanction of extensive priority payments where equitably justified, it seems unlikely that first-priority recognition of severance benefits would create the pervasive debilitating effect upon reorganization proceedings foreseen by petitioners. Where they exist at all, severance agreements arise in larger corporate entities. In many cases provision is made for the payment of the benefits from union funds. Even in the unique circumstances of Grant, the largest corporate bankrupt in history with several hundreds of millions of dollars received and administered by the Trustee and a large non-unionized labor force, the payment of severance benefits as a first-priority expense would have had no significant impact upon the Chapter XI administration.

Equity should recognize that the distinction between the treatment accorded the terminated employees and the consortium of banks headed by Morgan Guaranty in the instant bankruptcy proceeding results essentially from the greater bargaining power which the banks employed during their negotiations with Grant prior to bankruptcy. As a result, the banks have the luxury of satisfying their secured claims against the debtor from a fund of hundreds of millions of dollars set aside in 1978 for the satisfaction of bank claims, certain other claims, and costs and expenses of administration of the bankruptcy proceedings. To the extent they are relegated to the status of general unsecured creditors, the terminated employees may look only to the $35,000,000 residual fund.

The severance benefits each employee knew would accrue upon the termination of his employment represented his "security" retained for continuing his employment, just as the security interest which the banks retained represented security for the repayment of funds they advanced. Not only did the security of severance benefits induce the employees' initial acceptance of employment, but it also induced their continued employment with the debtor-in-possession during Chapter XI proceedings. The debtor-in-possession was ready and willing to honor the commitment to the employees. The Trustee and the banks are not.

Thus, the decision below is fully consistent with the express terms of § 64a(1) of the Bankruptcy Act and the Act's fundamental purpose to apply assets equitably.

CONCLUSION

It is respectfully submitted that the petitions for a writ of certiorari should be denied.

Dated: New York, New York
April 30, 1980

Respectfully submitted,

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 79-1458
No. 79-1459

CHARLES G. RODMAN, as Trustee of the Estate of W. T. Grant Company, Bankrupt, and MORGAN GUARANTY TRUST COMPANY OF NEW YORK,

Petitioners,

—v.—

ALTON RINIER, as Agent for Certain Employees of Bankrupt; Answering Employees of Bankrupt; Local 807-IBT; Retail Clerks International Association; and National Labor Relations Board,

Respondents.

BRIEF OF RESPONDENT ANSWERING EMPLOYEES OF BANKRUPT IN OPPOSITION TO PETITIONS FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Where employees have a contractual right to severance pay upon discharge, and they confer beneficial services upon the Debtor-in-Possession during a Chapter XI proceeding and are discharged during that proceeding, does the absence of an order of the Bankruptcy Court adopting the severance pay policy of the Debtor-in-Possession constitute a rejection of such severance pay policy?

2. Does the subsequent failure of the Chapter XI proceeding result in a retroactive rejection of the severance pay policy of the Debtor-in-Possession?

STATEMENT OF THE CASE

Although the instant case involves an employer and its employees, the issues can be focused on more clearly if the following hypothetical set of facts had been involved.

Suppose a vendor had a contract to sell goods to a debtor. Before delivery the debtor files a Chapter XI, accepts delivery *after* the XI is filed, and uses the goods but does not pay for them. If the Chapter XI proceeding fails and results in an adjudication, what is the status of the vendor's claim?

According to the Petitioners, the contract of sale was executory because it predated the Chapter XI. Since it was executory, it remained executory until rejected or adopted. Since it was never adopted by court order, the contract must be deemed rejected either by implication or by the adjudication, and the vendor would be a general creditor.

This is what the Petitioners' arguments boil down to in *Grant*. We respectfully submit that this is not the law in the Second Circuit, nor in any other Circuit. There is no conflict between the Courts. Certiorari should be denied.

This brief is submitted on behalf of a number of non-union employees of Grant who were discharged during the Chapter XI proceeding. They are named in the caption as "Answering Employees of Bankrupt". The principles involved in this case affect all former employees of Grant similarly situated and not represented by counsel.

Petitioners have recited the facts in detail and most are not really in dispute. The Petitioners' interpretation of some of the facts require clarification and amplification.

Severance pay for Grant's employees was fixed by rules and regulations promulgated by Grant. The benefits applied to

union and non-union employees and this policy was in effect prior to October 2, 1975, the date the Chapter XI Petition was filed.

Although both Petitioners have asserted that the severance pay benefits were "*earned*" prior to the filing of the Chapter XI, this simply is not so. Severance pay was not "earned" unless and until an employee was discharged. If an employee voluntarily left Grant's employ, or was discharged for cause, he forfeited his right to severance pay. The length of employment with Grant had nothing to do with his *right* to severance pay. Only the *amount* of severance pay was related to the length of time he was employed.

Grant's rules and regulations governing severance pay were *never rejected* by court order. They were in force at the beginning of the Chapter XI proceeding on October 2, 1975, and they were in effect at the time each employee was discharged during the Chapter XI.

The Petitioners contend, however, that since Grant's severance pay benefits were not expressly *adopted* by Grant as a Debtor-in-Possession pursuant to court approval, they should be deemed rejected by implication or retroactively rejected by Grant's adjudication.

The Petitioner-Trustee also claims the Debtor in Possession "informed its employees * * * of the suspension of the payment of severance pay benefits during the pendency of the Chapter XI case, subject to further order of the Bankruptcy Court".* To support this contention in the courts below, the Trustee relied upon the testimony of Richard McLean who referred to a store manual which stated that "termination" pay was subject to approval of the Bankruptcy Court. He testified that the manual was placed in the stores "some time after October 2", although he did not testify that this was seen by Grant's employees.

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* See p. 5 of Trustee's Petition. Actually, the Bankruptcy Court *did not order* the suspension of severance benefits during the XI.

McLean further testified about a notice which was posted in the stores in January of 1976, *four months after the Chapter XI began*. The notice did not state that severance pay policies were abolished, but only that the stores were not "authorized" to make severance payments. McLean did not testify that the notice was placed in a conspicuous place in the stores where it was seen by all of the employees.

The foregoing constituted the only proof by the Trustee as to how the employees were "informed" that severance pay was suspended.

On October 28, 1975, less than one month after the Chapter XI was filed, Grant obtained an order authorizing it to pay severance benefits to John Sundman, former senior executive of the bankrupt.* Prior to the Chapter XI case, Mr. Sundman had an employment contract with Grant which included severance pay benefits.

The case of Mr. Sundman constitutes an interesting example of the double standard employed by the Debtor-in-Possession in treating severance pay for Grant's employees. The application to pay severance to Mr. Sundman was approved without objection by the creditors committee, of which the Petitioner, Morgan Bank, was a charter member.

Mr. Sundman had been employed by Grant under a written contract made only slightly more than a year before the Chapter XI petition was filed. Under this contract, Mr. Sundman became entitled to severance pay in full if he were discharged. Although Mr. Sundman worked for the Debtor-in-Possession *for less than one month*, he was awarded the full *six months severance pay* with the blessing of the creditors, including the Morgan Bank.

Although both Petitioners in this Court are claiming that the Courts below were wrong in awarding severance pay to the non-executive employees as an administration expense priority, Grant's Petition for Mr. Sundman read in part as follows:

---

* See top of p. 6 of Trustee's Petition.

> "It is also the understanding that debtor's obligations to make such payments *shall constitute an expense of administration*."
>
> " * * * It had been the general policy of W.T. Grant Co. to provide severance pay to terminated employees and the understanding between debtor and Mr. Sundman is consistent with this policy and with the provisions of this agreement". (Emphasis supplied)

Perhaps the case of Mr. Sundman was designed or intended by the Debtor-in-Possession to set an example for the non-executive employees to follow, and to encourage them to stay on the good, but sinking ship Grant, and to lend a hand in keeping it afloat. Whether intended or not, the employees did precisely that. Instead of seeking other employment, they stayed on board, kept Grant alive for more than six months, and by orderly liquidating stores all over the country, generated over 600 million dollars for all of Grant's creditors.

The dramatic difference between the treatment of Mr. Sundman and the other employees of Grant illustrates the inequity of the Petitioners' position. While consenting to the payment of *six months severance* to Mr. Sundman, although he worked for the Debtor-in-Possession *for less than one month*, the Petitioners insist on a pro-rata formula for the *non-executive employees* based on the length of time they worked in the Chapter XI.

We submit that by any standard of equity, the decision of the Court of Appeals for the Second Circuit was correct and not in conflict with the decisions of any other Circuit.

WHY THE WRIT SHOULD BE DENIED

There is no substantive conflict between the decision of the Court of Appeals in the instant case and the decisions of the Courts of Appeals in *In re Mammoth Mart*, 536 F.2d 950 (1st Cir. 1976) and *In re Public Ledger, Inc.*, 161 F.2d 762 (3rd Cir. 1947).

If the *Grant* case had been heard by either the First or the Third Circuits, we believe the decision would have been identical. While *Mammoth* and *Public Ledger* may differ from *Grant* or *Straus-Duparquet** in the *mechanics* as to how severance pay should be computed, this difference in approach would not affect the *result* in the instant case. The decision in *Grant* was for the most part based on the principle that the employees conferred *beneficial* services upon the Debtor-in-Possession during the Chapter XI proceeding. Not a single decision anywhere requires that the acceptance of benefits by a debtor-in-possession be sanctified by court approval in order for such acceptance to create an administration expense priority.

The "benefits" principle is an equitable one. While both the Bankruptcy Act and the new Bankruptcy Code are founded upon equitable principles, they do not require *equal* treatment of all creditors, regardless of class. What they do mandate is *equitable* treatment. The decision in this case *is* equitable for all of the creditors.

In *Grant*, all of the employees conferred benefits on the Debtor-in-Possession by working until they were discharged. When each employee was discharged, the agreement with the Debtor-in-Possession was no longer executory. At that point, *it was fully executed*. The only remaining obligation of the employer was to pay each employee the severance pay to which he was entitled.

The severance pay obligation was more than a pre-petition commitment. It was a recognition that the employees had performed vital services and rendered important benefits in an attempt to rehabilitate an ailing debtor. Although Grant was subsequently adjudicated, the bankruptcy resulted in what the Morgan Bank's Petition described as "the largest corporate liquidation in the history of the United States".**

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* *Straus-Duparquet v. Local Union No. 3*, 386 F.2d 649 (2d Cir. 1967), which was followed by *In re Bohack Corp.*, 535 F.2d 1240 (2d Cir. 1975), *cert. denied*, 425 U.S. 966; *In re Unishops, Inc.*, 554 F.2d 305 (2d Cir. 1977).

** See p. 1, 2 of Morgan Bank's Petition.

Without the services of the employees who are the targets of the Petitioners' appeal, we believe that even the Petitioners would concede this would not have been possible.*

I

THE CLASSIFICATION OF SEVERANCE PAY IN GRANT AS AN ADMINISTRATION EXPENSE DOES NOT CREATE A CONFLICT WITH THE OTHER CIRCUITS

Much has been written in both petitions about the purported conflict between other Courts of Appeals and the decisions by the Second Circuit in *Grant* and *Straus-Duparquet*. If a conflict exists it goes to the *method* of computing severance pay rather than the result.

In both *Public Ledger* and *Mammoth Mart*, the courts wrote that severance pay matured day to day as a debt, while in *Straus-Duparquet*, the Second Circuit held that severance was compensation for termination, payable *only* when and if the employee was discharged.

The decision by the Third Circuit in *Public Ledger* almost 33 years ago when the concept of severance pay was in its early stages was understandable. The employees in *Public Ledger* filed their claim for severance as "wages" (p. 771) and the court agreed that severance payments were "wages" (p. 773). If the employees had contended that severance pay was compensation for termination, or that they had rendered valuable services to the debtor which equalled or exceeded in value the severance payments, we submit that the decision would have been different.

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* For example, Grant's Petition when it filed for a Chapter XI arrangement stated:

> "Termination of operations for even a limited period of time would destroy the goodwill of the debtor's business and severly prejudice the interest of its estate, its creditors, and stockholders, and would cause the loss of over 62,000 jobs" "

A close examination of *Mammoth Mart* discloses the facts in that case were different—crucially different. When the employees in *Mammoth Mart* applied for *more* severance, more than the four weeks' salary they had been previously paid as an administration expense by the debtor-in-possession without court order, they offered no proof that the *additional* claim they were making related to their employment *after* the Chapter XI was filed (p. 953).

The First Circuit accordingly held:

> " * * * the wages and four week's salary severance pay that the Debtor-in-Possession paid appellants *fully compensated them for the services performed after the petition was filed. The claims for additional severance pay are based entirely upon services performed by appellants to the debtor and as such, are not entitled to priority*". (p. 955) (Emphasis supplied)

If the employees in *Mammoth Mart* had *not* already been fully compensated for the benefits they had conferred on the debtor-in-possession, we submit that the result would have been different. The First Circuit indicated as much in its footnote No. 4 on page 955, where it emphasized:

> "Here where the debtor-in-possession made no new promise, but simply permitted the employees to continue their employment, *it is bound to pay under the terms of the debtor's contract only to the extent that the debtor-in-possession was the recipient of beneficial services*". (Emphasis supplied)

Having thus found that the employees were *fully* compensated for the services they rendered to the debtor-in-possession, there was no need for the First Circuit in *Mammoth Mart* to embark on a discussion of the *mechanics* of computing severance pay. The belief of the First Circuit that severance pay was earned day to day, rather than compensation for termination of employment, was *dictum* and regardless of its appeal to some courts, should be disregarded.

The decision in *Mammoth Mart* is really based upon the "benefits" principle, which is identical to the holding of the Second Circuit in *Grant*, where the Court wrote:

> "Under 'the decisions in this Circuit * * * an executory contract is binding on the debtor in possession if it receives benefits under it.' *In re Uishops, Inc.*, 553 F.2d 305, 309 (2 Cir. 1977) (Medina, J.). *Here, Grant received benefits under the contracts by permitting the workers to continue in its employ after it entered Chapter XI*. As the district court stated, Grant secured 'the services of an experienced Grant personnel during the Chapter XI proceeding. Apparently, had Grant been forced to terminate all its employees upon entering Chapter XI and therefore recruit a new work force, even its short-lived Chapter XI attempt would have been virtually impossible' ". (Emphasis supplied)*

Since Grant permitted the employees to continue their employment, it was bound to pay them to the "extent that the *Debtor-in-Possession was the recipient of beneficial services*" (*Mammoth Mart*, p. 955), which is precisely what the Second Circuit in *Grant* held. Therefore, *Grant* does not depend upon the rule in *Straus-Duparquet* and is consistent with *Mammoth Mart*. If *Straus-Duparquet* had never been decided, *Grant* would have ended up the same way, whether in the Second or any other Circuit.

In re Unishops, 553 F.2d 305, 309 (2d Cir. 1977), which is the basis for the *Grant* decision, is a case in point. There, Zelin, the Chief Operating Officer of Unishops, had a contract which paid him a salary of $100,000 per year and called for $100,000 severance if he were dismissed. Some six months after *Unishops* filed its Chapter XI, Zelin was discharged. The Second Circuit affirmed the award to him of the *full* amount of severance as an administration expense, basing its decision on the "benefits" principle:

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* Joint Appendix, p. 5a.

> "It is *settled law that a claim arising under an executory contract is entitled to priority 'if the trustee or debtor-in-possession elects to assume the contract or if he receives benefits under it'. American Anthracite and Bituminous Coal Corp. v. Leonardo Arrivabene*, S.A., 280 F.2d 119, 124 (2d Cir. 1960); *In re Mammoth Mart, Inc.* 536 F.2d 950, 954 (1st Cir. 1976). *As Zelin continued in Unishops' employ for some time after it entered Chapter XI, we believe the debtor received benefits under the executory contract and, hence, the claimant is entitled to priority*". (p. 308) (Emphasis supplied)

Each employee of Grant should be considered a *Zelin*. Since each Grant employee continued in Grant's employ "for some time after it entered Chapter XI" and Grant unquestionably received the benefit of his services, each Grant employee is entitled to the same administration expense priority for his severance pay as Zelin received in *Unishops*.*

There is no conflict in the several Courts of Appeals on this rule.

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* In a footnote on p. 14 of the Morgan Bank's Petition, it remarked that in *Unishops*, "the company did better by paying severance pay than it would have by honoring the full contract." The same observation might be made in *Grant*. Grant obviously "did better" by letting the employees stay on, thinking their severance pay benefits were intact, than by moving to reject severance pay at the outset of the Chapter XI. Had it done so, it would have been "suicidal" for Grant, to use the word of the Trustee in the court below, because it could have triggered a mass walk-out by the employees.

II

SINCE THE DEBTOR-IN-POSSESSION ACCEPTED BENEFITS FROM THE EMPLOYEES, IT WAS NOT NECESSARY FOR FORMAL COURT ADOPTION TO ESTABLISH AN ADMINISTRATION EXPENSE PRIORITY

The Petitioners argue that since the Bankruptcy Court never ordered the *adoption* of Grant's severance pay policy, it should be deemed rejected. This contention is not correct and the law is the same in the Second and other Circuits referred to by the Petitioners.

The Trustee relies upon *American Anthracite and Bituminous Coal Corp. v. Leonardo Arrivabene, S.A.*, 280 F.2d 119 (2d Cir. 1960) to support its contention that assumption of pre-bankruptcy executory policies requires court approval. But *American Anthracite* stands for more than that. In that case, the court distinguished between *assuming* a contract and *receiving* benefits under it.

There is a right to priority, wrote the Second Circuit in *American Anthracite*, if the debtor:

> "*assumes*" the contract because " * * * the trustee or debtor-in-possession has elected to make the contract of the debtor his own * * * ". (p. 124) (Emphasis supplied)

There is *also* a right to priority if:

> "* * * the trustee or debtor-in-possession *receive benefits* under the contract during the interval between the filing of the debtor's petition and the rejection of the contract * * * ", which "is an equitable right based upon the reasonable value of the benefits conferred, rather than upon the contract price". (p. 124) (Emphasis supplied)

Nowhere in the courts below did the Petitioners attempt to prove that the severance pay sought by Grant's employees was *more* than the reasonable value of the benefits conferred by them upon Grant. Indeed, considering the amount of money

Grant generated in its orderly liquidation, the reasonable value of the benefits conferred by its employees for all of Grant's creditors could well be *far more* than the severance pay awarded to them.

The Debtor-in-Possession itself brought this point home at the outset of the Chapter XI proceeding in October of 1975 in its petition for the arrangement:

> "14. Traditionally, the forthcoming Christmas season is the best sales period in the retail sales industry and the debtor has historically achieved its best operating results during this period. Debtor believes that the protection afforded it under Chapter XI will enable it to replenish its inventories and take advantage of the seasonal upturn of its business. Debtor anticipates that if it is allowed to continue its operations during this period that sufficient cash flow will be generated to enable the debtor to continue its operations into the new calendar year and to put the debtor into a position to implement successfully the economies in operations and other changes it proposes to make. If the debtor is not permitted to continue its operations as debtor-in-possession, its estate and its creditors will suffer and over 62,000 employees will lose their jobs, with the attendant hardships imposed on their families and communities".

Obviously, the 1975 Christmas season was of extreme importance to Grant. By working through the 1975 Christmas season, the employees generated a sizeable amount of cash for the Debtor-In-Possession. This illustrates how in some businesses, particularly one such as Grant's, profitability is telescoped into short, holiday periods when most of the year's sales are made. It also demonstrates that measuring the *benefits* which the employees conferred on Grant by the length of time they worked is irrelevant.

Without formal court adoption, or rejection for that matter, the Petitioners would like to sentence Grant's severance pay

policies to a place called "limbo", which apparently is a twilight zone midway between rejection and adoption, where the severance pay policies would never be heard from again, unless resurrected or buried by court order. This is an interesting but illogical proposition.

If *every* executory contract-vendor or employee were required to obtain *prior* court approval before he completed his contract with a debtor-in-possession, the courts would be swamped with literally millions of applications a year. This would create chaos—no,—it would completely paralyze the Bankruptcy Courts in this country. This is not the law and should not be made the law.

The cases cited by the Petitioners,

> *In re Gulfco Investment Corp.*, 520 F.2d 741 (10th Cir. 1975); *In re Maryvale Community Hospital, Inc.*, 456 F.2d 414 (9th Cir.), *cert. denied*, 409 U.S. 879 (1972); *In re American National Trust*, 426 F.2d 1059 (7th Cir. 1970); *Texas Importing Co. v. Banco Popular de Puerto Rico*, 360 F.2d 582 (5th Cir. 1966), and *Local Joint Executive Board AFL-CIO, v. Hotel Circle, Inc.*, F.2d (9th Cir. 1980) (Jt. App. IV)

for the proposition that *assumption* of *all* executory contracts requires prior court approval is a blanket misreading of those cases, which in any event have facts completely different from *Grant*. In each of those cases, the "benefits" principle was not involved. In each of them, the issue was whether the debtor-in-possession could be bound in the *future* to a contract without court approval.

American National Trust and *Texas Importing* involved executory contracts for the sale of land which were truly executory in nature and are distinguishable on those grounds alone from *Grant*.

Gulfco does not conflict with *Grant*. There the court held that it may enjoin a real property contract vendor from rescinding

his contract with the vendee-debtor, pending a determination by the trustee as to whether he should accept or reject the contract.

Rather than conflicting with *Grant*, the Ninth Circuit in *Hotel Circle*, which was decided early in 1980, distinguished between (a) adoption by a trustee of a long-term executory contract without court approval and (b) assumption of an executory contract which simply creates an administration expense. The Court found the reasoning against the authority of a Trustee to bind the estate to a "*long-term*" collective bargaining agreement beyond the term of his office more persuasive than if such assumption would "*merely establish a priority as an administration expense*". (p. 43-a, Petitioners' Joint Appendix) (Emphasis supplied)

Maryvale is not supportive of Petitioners' position, either. There the court reiterated the rule that only a court can *reject* an executory contract, that until it is rejected, it is "in full force and effect". (p.418)

This, of course, harmonizes with *Collier* which states:

> "*The failure to assume affirmatively an executory contract does not result at any time in a rejection of the contract.* Whether the debtor is in possession, or whether there is a receiver or trustee, the contract can be rejected only by affirmative action under § 313(1) and Chapter XI Rule 11-53 or § 357(2). *Unless so rejected, the contract continues in effect.*" 8 *Collier on Bankruptcy* ¶ 3.14[6] (14th ed. rev. 1975) (Emphasis supplied)

Since Grant's severance pay policies were concededly in effect when the Chapter XI was filed, they continued in effect *during* the Chapter XI. The alleged attempt by the Debtor-in-Possession to alert the employees to the possibility that severance pay might not be paid did not amount to a rejection. The necessity of affirmative court action by the debtor-in-possession to reject executory arrangement was hammered home by the Fifth Circuit in *In re Alfar Dairy, Inc.*, 458 F.2d 1258, 1261 (5th

Cir. 1972), *cert. denied* 409 U.S. 1048 (1972), where the Court wrote:

> " . . . *even though a party to an executory contract with a bankrupt may know by one means or another that the bankrupt does not intend to perform, the contract is not voided as a result of this knowledge but remains in force until rejected pursuant to the Act.* Any other rule could result in chaos and injustice in bankruptcy proceedings, which often involve hundreds of parties and strict statutory deadlines for filing claims. *Informal, ad hoc compliance with the general contours of the Act is not sufficient.*" (Emphasis added)
>
> See also *Unishops*, *supra*.

The severance pay policies of Grant *were* therefore still in effect at the moment each employee was discharged during the Chapter XI. At the moment of discharge, when the *right* to severance pay for the first time became fixed, the agreement with the employee was no longer executory. It had been completely executed by the employee during the Chapter XI. *In Re San Francisco Bay Ex.*, 50 F. Supp. 344; *Crittenden v. Lines*, 327 F.2d 537 (9th Cir. 1964); *In Re Computer Utilization, Inc.*, 508 F.2d 673 (5th Cir. 1975).

Finally, the Petitioner-Trustee argues, the adjudication of Grant as a bankrupt on April 13, 1976, retroactively caused a rejection of *all* of Grant's executory policies and contracts, *as of October 2, 1975.** The Petitioner does not cite a single authority to support this rather startling proposition. And with good reasons. First of all, there is none, at least none that we could find. Secondly, it just does not make sense.

The purpose of a Chapter XI is to rehabilitate an ailing debtor. To induce vendors and others to deal with the debtor-in-

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* No explanation is offered by the Petitioner-Trustee as to what effect this retroactive rejection would have on Mr. Sundman, who received his windfall shortly after that date.

possession, the Bankruptcy Act, § 64a(1) affords these creditors a first priority administration expense. It would defeat the purpose of that section if every vendor or employee had to speculate on the ability of the debtor-in-possession to rehabilitate itself, or face the danger of having his claim as a first priority administration expense converted into a general claim long after he delivers his goods or renders his services. Under these circumstances, no creditor would ever deal with a debtor-in-possession.

We do not believe that this is the law in the Second or any other Circuit.

CONCLUSION

The Petitioners argue that if the decision by the Second Circuit in *Grant* is not reversed, debtors will go forum shopping to determine which Circuit suits their needs. The rule in the "other" Circuits, contend the Petitioners, is the better one and should be followed by all of the Circuits in the United States. According to the Petitioners, this Court should set a national rule which would be applicable to every bankruptcy situation.

We do not believe that the intent of either the Bankruptcy Act or the new Bankruptcy Code would be met if a court imposed hard and fast rules which would apply to every conceivable set of facts. The philosophy underlying the bankruptcy laws is an equitable one, designed to fashion solutions to problems as they emerge and to set forth broad guidelines for the courts to follow.

The authorities cited by both the Petitioners and ourselves demonstrate that the courts have reached different conclusions on different sets of facts which is as it should be. It is only through a case-by-case determination of the facts peculiar to each case that equitable rules can be tailored to fit each problem.

We respectfully submit this can be done most efficiently and effectively by the local bankruptcy courts, subject to the usual

review by the district courts, and the several Courts of Appeals, and subject to review by this Court only where there has been a substantial and radical departure from truly recognized *substantive* law. To ask this Court to act as a "super" bankruptcy court every time one Court of Appeals criticizes another would open the floodgates to every difference of approach or difference of opinion expressed by a court to meet the facts unique to the case before it.

The instant case provides a unique set of facts which has properly been decided according to the benefits conferred upon the Debtor-in-Possession by the employees. To adopt the position of the Petitioners would equalize the status of the employees with the general creditors, even though the general creditors did not confer any benefits upon the Debtor-in-Possession. This would be in clear violation of the applicable Bankruptcy Act. Of equal importance, it would be inequitable.

Certiorari should be denied.

Dated: New York, New York,
April 23, 1980.

Respectfully submitted,

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Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-1458

MORGAN GUARANTY TRUST COMPANY OF NEW YORK,

Petitioner,

v.

ALTON RINIER, as Agent for Certain Employees of Bankrupt; ANSWERING EMPLOYEES OF BANKRUPT; LOCAL 807-IBT; RETAIL CLERKS INTERNATIONAL ASSOCIATION; and NATIONAL LABOR RELATIONS BOARD,

Respondents.

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

The National Labor Relations Board ("NLRB") has filed a brief opposing certiorari in this case. Unlike the other respondents, the NLRB agrees that a conflict exists among the Circuits on the treatment of severance pay claims in proceedings under the Bankruptcy Act and also agrees that the existence of that conflict is acknowledged by the Court below. But the NLRB opposes the petitions of the Grant Trustee and of Morgan Guaranty on the ground that the conflict is not one of general importance in light of the enactment of the new Bankruptcy Code.

The position of the NLRB is untenable. The conflicting interpretations among the Circuits, as to whether severance pay accrues over a period of time or all at the moment of termination, survive under the new Code because the differing rationales of the Circuits are of pre-

cisely the same applicability to the concept of administration expenses under the new Code as under the old Act.

Thus, if the First and Third Circuit's understanding of severance pay is correct, that it is a form of wages earned over time, then allocation will continue to be the rule in those Circuits under the new Code. If the Second Circuit's view is correct, that severance pay is in the nature of damages and is earned as compensation for termination (with only the amount varying according to length of service), then in Second Circuit cases under the new Code severance pay will always be an administration expense for any employee let go after a bankruptcy filing.

The NLRB tries to minimize the conflict by contending that the new wage priority provisions provide "a significantly changed statutory context" (NLRB Br. at 7). In fact, there is no substantive change in the statutory approach (*compare* Act §§ 64a(1) and (2) with Code §§ 503(b) and 507(a)(1) and (3)), and the legislative history of the Code shows that Congress contemplated no change other than increasing the amount of the pre-filing wage priority from $600 to $2,000 (*see* 10 Resnick and Wypyski, Bankruptcy Reform Act of 1978—A Legislative History (1979) at 297; House Rep. No. 95-595 in 5 U.S. Code Cong. & Ad. News (1978) at 6313).

Dated: New York, New York
May 20, 1980

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